

NOTE

MIDCOAST INTERSTATE TRANSMISSION, INC. v. FERC

I. INTRODUCTION

Midcoast Interstate Transmission, Inc. (Midcoast), along with two unincorporated associations, filed a petition requesting review of the Federal Energy Regulatory Commission's (FERC), order granting Southern Natural Gas Company a certificate of public necessity and convenience. Prior to 1996, Midcoast was the sole supplier of natural gas to the cities of Huntsville and Decatur, Alabama (Cities). In January of 1996, the Cities entered into a twenty-one year contract with Southern Natural Gas Company (Southern), which was to become effective upon completion of Southern's proposed North Alabama Pipeline Project.¹ In order to begin construction of the North Alabama Pipeline, Southern had to apply for a certificate of necessity and convenience with the FERC; Southern's certificate was approved in July of 1996. Along with Midcoast, two unincorporated associations were opposed to the North Alabama Pipeline Project. The first group was the "GASP Coalition" (GASP), a group of individuals concerned with the environmental aspects of the pipeline. The second group was the "Citizens Opposing North Alabama Pipeline Project" (CONAPP),² a group organized with the sole purpose of challenging Southern's expansion project.³

The petitioners claimed that the FERC's granting of an order of convenience and necessity to Southern's expansion project and its denial of Midcoast's certificate order for an environmentally superior alternative were arbitrary and capricious. Also, petitioners challenged the FERC's presumption that Southern would be able to roll the construction costs into their system wide rates, and claimed that this was an improper application of the FERC's Pricing Policy.⁴ Finally, GASP and CONAPP argue that the FERC authorized Southern to exercise the power of eminent domain, which is a violation of the Fifth Amendment to the United States Constitution.⁵

1. *Midcoast Interstate Transmission, Inc. v. FERC*, 198 F.3d 960 (D.C. Cir. 2000).

2. Citizens Opposed to the North Alabama Pipeline Project is a "grassroot organization started by the citizens of North Alabama who are opposed to the construction of the North Alabama Pipeline." Available at www.dms.auburn.edu/~gravejj/Ernie.html.

3. *Midcoast*, 198 F.3d at 967.

4. *Id.*

5. *Midcoast*, 198 F.3d at 967.

It was held by the United States Court of Appeals for the District of Columbia Circuit that the FERC neither abused its discretion, nor acted outside the boundaries of the law in granting Southern's certificate and, therefore, the petition for review was denied. The court stated that the FERC's action of granting Southern's certificate was not arbitrary or capricious; that the FERC took the "hard look" at the environmental issues as required by the National Environmental Policy Act (NEPA).⁶ Also, the FERC was entitled to take competition into consideration when granting its certificate. The fact that the Cities signed a twenty-one year contract with Southern instead of remaining with Midcoast suggests that the Cities wanted more options when choosing a gas company. It was held that the FERC was fair in applying its Pricing Policy. Southern's proposal successfully met the FERC's two-prong test used to determine if rolled-in pricing is applicable. The court further declared that the FERC did not act in violation of the Fifth Amendment. As long as the project serves some form of public purpose, the Constitution is satisfied. In addition, section 717f(h) of the Natural Gas Act (NGA) allows the power of eminent domain to be implemented once a certificate is issued.⁷

The court's decision to uphold the FERC's granting of Southern's certificate is based on three pivotal facts. First, granting Southern's certificate would allow competition to be introduced into a market where none had previously existed. The desire for this was apparent by the Cities signing a long-term contract with Southern. The FERC was entitled to rely on the general economic theory that the introduction of competition to the market would benefit consumers.⁸ Second, the FERC found that the Cities would see both economic and operational benefits from the building of the North Alabama Pipeline. The project was expected to realize a long-term economic benefit of twenty-five million dollars. The FERC also recognized the following four operational benefits that the project would offer existing customers: (1) enhancement of system reliability; (2) increase in the availability of interruptible transportation service; (3) availability of new opportunities for marketers and shippers; and (4) a provision of firm service for increased shipments to the Cities by two Southern system shippers.⁹ Third, although Southern's proposal was environmentally inferior to Midcoast's proposed alternative, it was found that the environmental effects of Southern's project were limited, as well as controllable, as long as specified mitigation measures were taken.

This article will discuss the background of certain aspects that the FERC considers when looking at a proposal. Also, this article will go into a detailed analysis of the court's decision to deny Midcoast's alternative proposal and grant Southern's proposed North Alabama Pipeline Project. Finally, the future implications of the FERC's new Pricing Policy will be

6. Corridor H. Alternatives, Inc. v. Slater, 166 F.3d 368, 374 (D.C. Cir. 1999).

7. 15 U.S.C. § 717f(h) (1994).

8. *Midcoast*, 198 F.3d at 968.

9. *Id.* at 971.

discussed, including how the outcome of this case could have been different had the new policy been applied.

II. BACKGROUND

A. Certificate Process

Section 717f(c)(1)(A) of the NGA requires that:

no natural gas company or person which will be a natural gas company upon completion of any proposed construction . . . shall engage in the transportation or sale of natural gas . . . or undertake the construction or extension of any facilities therefor . . . unless there is in force with respect to such natural gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations.¹⁰

Upon application for this certificate, the FERC's "function is not only to appraise the facts and to draw inferences from them, but also to bring to bear upon the problem an expert judgement and to determine from its analysis of the total situation on which side of the controversy the public interest lies."¹¹ A certificate of public necessity and convenience will be granted to "any qualified applicant . . . if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter. . . ."¹²

B. Rate Setting

The first issue addressed in setting prices is whether projects will be priced on a rolled-in basis or on an incremental basis.¹³ The FERC used to make this determination upon completion of construction when gas companies sought to recover the costs for these facilities; however, there is a more recent trend of making this pricing determination during the certificate process. The purpose of making the pricing determination during the certificate process is to "provide parties with greater certainty about the rate design that will be applied."¹⁴ The FERC felt that the new market created by Order 436 and 636¹⁵ resulted in potential shippers needing to know the rates they will face prior to making a decision of whether to

10. 15 U.S.C. § 717c(1)(A) (1994).

11. *FPC v. Transcontinental Gas Pipeline Corp.*, 365 U.S. 1, 7 (1961).

12. 15 U.S.C. § 717f(e) (1994).

13. Rolled-in rates involve rolling-in the expansion costs with the existing facilities. Incremental rates consist of separate cost of service, and separate rates for the existing and expanding facilities. *Pricing Policy for New and Existing Facilities Constructed By Interstate Natural Gas Pipeline*, 71 F.E.R.C. ¶ 61,241, at 61,914 (1995).

14. 71 F.E.R.C. ¶ 61,241, at 61,915.

15. Order 436 was implemented to give pipelines incentives to become open access, which means to become common carriers and to provide transportation services to any customer requesting service. Order 636 was implemented in 1992; its goal was to achieve a national gas market where a buyer can reach many sellers by meaningful access to the pipeline transportation grid. Order 636 essentially made what Order 436 only suggested into a requirement. MARLA E. MANSFIELD, *ENERGY POLICY: THE REEL WORLD* 278 (The University of Tulsa, College of Law (unpublished) 2000).

commit to a long-term contract.¹⁶ In addition to determining the rate design during the certificate process, the FERC also added another new feature to its Pricing Policy to help adjust to the new market created by Orders 436 and 636. When a pipeline seeks rolled-in pricing, the FERC will base its decision on evaluation of system-wide benefits offered by the project and on the rate impact on existing customers. The FERC will also look at the extent to which the new facilities are integrated with the existing facilities in determining whether to apply rolled-in pricing. A gas company requesting rolled-in pricing must identify what benefits it will offer its customers, as well as demonstrate how the expansion project will provide the claimed benefits. The FERC generally recognizes two types of benefits: the first being operational benefits, which consist of increased access, reliability, flexibility, or new services; and the second type of benefit being monetary benefits, which consist of fuel or other cost savings, or of the prevention of rate increases from unrelated load loss.¹⁷ These benefits are analyzed in context with the rate increase to existing customers which is produced by rolled-in pricing. The FERC will apply a presumption in favor of rolled-in rates when the rate increase to customers is five-percent or less; however, projects where the pipeline is placed at risk for cost recovery will not qualify for the five-percent presumption.¹⁸ Although, even if a pipeline project does not qualify for the five-percent presumption, it is still possible to qualify for rolled-in rates if the company can show that the benefits from the expansion project are proportionate to the rate impact.

C. *New Rate Setting Policy*

In June of 1999, the FERC held a public conference on the issue of anticipated natural gas demand in the northeastern United States. Also discussed were some other issues such as the timing and type of growth, and the effect projected growth will have on existing pipeline capacity. Based on the feedback received at this conference, the FERC decided to revisit its policy for certificating new construction, in particular, its policy for determining whether there is a need for a specific project and whether, on balance, the project will serve the public interest.¹⁹ One of the major changes in the Pricing Policy is that now the market plays a greater role in determining which projects should be built. The threshold requirement in establishing public convenience and necessity is that the pipeline's proposed expansion project has to be able to stand on its own financially, without relying on subsidization from its customers.²⁰ In the current Pricing Policy, the FERC offers a presumption for rolled-in pricing, as discussed above. By eliminating the subsidization, the FERC is recognizing

16. 71 F.E.R.C. ¶ 61,241, at 61,915.

17. *Id.* at 61,916.

18. 71 F.E.R.C. ¶ 61,241, at 61,916.

19. *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 F.E.R.C. ¶ 61,227, at 61,737 (1999).

20. *Id.* at 61,916.

that a policy of incremental pricing sends the proper pricing signals to the market.

The objective of the new Pricing Policy is for the applicant to make a sufficient showing of the public benefits of its proposed project and to outweigh any residual adverse effects, before being considered for a certificate. Such residual adverse effects consist of negative effects on the interests of the applicant's existing customers, the interests of competing existing pipelines, and the interests of landowners and surrounding communities.²¹ In order to show that a proposed project meets the public convenience and necessity requirement, an applicant must show public benefits that are proportional to the project's adverse impacts mentioned above.²² The purpose of this is to encourage companies to submit applications designed to avoid or minimize adverse effects on relevant interests. Another purpose of this new Pricing Policy is to provide certainty about the decision-making process and the impacts that would result from the approval of the project. This is why the new policy will not be applied retroactively.²³ The FERC wants to provide participants with certainty as to the economic consequences of construction in the certificate proceedings. Thus, the new Pricing Policy could not have been applied to the case at hand because the certificate process had already been completed and once these economic decisions have been made, they are difficult to undo.

D. Countervailing Policy Reasons

Although the Alabama-Tennessee alternative proposed by Midcoast was found to be environmentally superior, the court stated the FERC based its approval of Southern's proposal on "countervailing policy reasons."²⁴ One of these "policy reasons" was competition. Granting Southern's proposal would "provide for the first time in forty-seven years a competitive alternative for Alabama-Tennessee's current captive customer."²⁵ Another "policy reason" is the lack of a more acceptable alternative. The FERC looked for routes around the Wheeler National Wildlife Refuge,²⁶ a highly sensitive environment; however, the court found that this area could not be avoided without building a significantly larger pipeline.²⁷ Over a hundred variations were presented to the FERC. These variations were based on minimizing the environmental impacts of Southern's proposal. In considering these variations, certain environmental is-

21. 88 F.E.R.C. ¶ 61,227, at 61,747.

22. *Id.*

23. 88 F.E.R.C. ¶ 61,227, at 61,750.

24. *Midcoast Interstate Transmission, Inc. v. FERC*, 198 F.3d 960, 966 (D.C. Cir. 2000).

25. *Id.*

26. The Wheeler National Wildlife Refuge was established in 1938 as an attempt to restore the population counts of waterfowl which had been drastically reduced due to extensive droughts in the early 1930s. The Wheeler Refuge is approximately 34,500 acres in size and its main function is to provide food and protection for waterfowl, as well as other wildlife species in their natural habitat. *Available at* www.calhoun.cc.al.us/Nat_Science_Div/gow.

27. *Order Issuing Certificate, Southern Natural Gas Co.*, 79 F.E.R.C. ¶ 61,280, at 62,205 (1997).

sues were examined, such as proximity to residences, topography, and sensitive resources. The Triana Variation, for example, was found to be environmentally preferable to a portion of Southern's proposal, because it crossed north of the Tennessee River instead of through it. However, this was subject to approval by the Fish and Wildlife Service (FWS) because it would involve surface disturbance.²⁸

E. Alabama-Tennessee Alternative

In April of 1997, Alabama-Tennessee Natural Gas Company (now Midcoast) filed an application with the FERC requesting a certificate of public convenience and necessity, authorizing it to serve the Cities through its existing system. This proposal was meant to fully replace Southern's proposed North Alabama project. The Alabama-Tennessee alternative would consist of two compressor units and related facilities that would deliver gas to the existing delivery points of Huntsville and Decatur. It was estimated that the cost of the proposed facility would be \$1,806,748.00. "Alabama-Tennessee stated that it would finance the facilities with funds on hand, funds generated internally, and borrowing under revolving credit agreements."²⁹ Alabama-Tennessee proposed to charge rates of \$4.78/Dth (demand), \$0.472/Dth (commodity), and an annual rate of \$2.98/Dth. These rates were said to be "below current maximum rate levels and below the rates proposed by Southern" and, therefore, made the Alabama-Tennessee alternative economically preferable.³⁰

Midcoast also presented the FERC with another alternative proposal in October of 1997, called the Hartselle System Alternative. The purpose of the Hartselle System Alternative was to replace the Triana Variation³¹ as the route through the Wheeler refuge. The Hartselle project would replace the final leg of Southern's North Alabama project. It was proposed that Southern build the first ninety-eight miles of the pipeline and then in lieu of Southern's proposed route north of Milepost ninety-eight, Midcoast would construct approximately eight miles of pipeline to Midcoast's existing Hartselle Lateral.³² Midcoast argues that the Hartselle project would best meet the environmental concerns because it satisfies the FWS' policy requirement that pipelines crossing the refuge follow existing corridors.

28. *Id.*

29. Order on Application, *Alabama-Tennessee Natural Gas Co.*, 79 F.E.R.C. ¶ 61,283, at 62,239 (1997).

30. *Id.*

31. The Triana Variation was found to be unacceptable by the Fish and Wildlife Service because it is in contrast with their policy for pipeline routing across the refuge and requires directional drilling. Order Dismissing Application, *Midcoast Interstate Transmission Inc.*, 83 F.E.R.C. ¶ 61,195, at 61,827 (1998).

32. 83 F.E.R.C. ¶ 61,195, at 61,827-28.

F. *Environmental Impact Statement*

Under NEPA, it is required that each proposal presented to the FERC include:

[A] detailed statement by the responsible official on: a) the environmental impact of the proposed action; b) any adverse environmental effects which cannot be avoided should the proposal be implemented; c) alternatives proposed to the proposed action; d) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity; and, e) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.³³

If for some reason the FERC had difficulty obtaining adequate information to make a reasoned assessment of the project's environmental impact, NEPA requires that it make a "worst case analysis" on the basis of available information.³⁴ Such a report ensures that the FERC will have the detailed information concerning the significant environmental impacts of the proposed project that it needs to consider when determining whether a project is necessary for public convenience. Publication of an Environmental Impact Statement (EIS) also serves a larger informational role. It gives the public the assurance that the agency has indeed considered environmental concerns in its decision-making process and provides a springboard for public comment.³⁵ However, the FERC is not bound by the environmental determination of the EIS. The Supreme Court has decided that NEPA itself does not mandate particular results, but only serves the purpose of requiring the FERC to consider the environmental aspects of its proposals. The policy goals of NEPA are realized through a set of "action-forcing procedures that require that agencies take a hard look at environmental consequences."³⁶

The Final Environmental Impact Statement (FEIS) for Southern's project concluded that Alabama-Tennessee's proposed alternative would result in far fewer environmental consequences as compared to Southern's proposed North Alabama Pipeline Project. Southern's proposal would result in limited adverse environmental impacts, only if proper mitigation measures were followed. This decision was based on information filed by Southern, as well as extensive fieldwork and research.³⁷ The FEIS developed and recommended additional mitigation measures it believed were appropriate and that would significantly reduce the environmental impact that would otherwise result from Southern's project. The FEIS recommended that "the measures be attached as conditions to any certificate

33. National Environmental Policy Act of 1969, 42 U.S.C. § 4332(2)(C) (1994).

34. *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 333 (1989).

35. *Id.* at 349.

36. *Robertson*, 490 U.S. at 350.

37. Fed. Energy Regulatory Comm'n, FERC No. 0109F, Docket Nos. CP96-153-000 and CP97-343-000, Final Environmental Impact Statement: North Alabama Pipeline Project, at 7-1 (May 1997) [hereinafter FEIS].

that is issued by the Commission."³⁸ The following are some of the factors considered in the FEIS and the recommended mitigation measures proposed to decrease the environmental impacts:

a) *Geologic Hazards*. Prior to construction, no sinkholes were identified along the construction route; however, landowners along the route have identified sinkholes on their property. It was recommended that Southern re-check these parts of the construction route and if sinkholes were found, Southern would have to identify the proper mitigation measures. It was also recommended that Southern have a qualified geologist available as technical support to help avoid sinkhole locations.³⁹

b) *Coal Reserves*. Southern's route would cross approximately 3.8 miles of federally-managed coal reserves and abandoned coal mines. "Southern must consult with the Department of Interior in order to determine the extent of the coal deposits beneath its pipeline route and if any areas along the route need to be adjusted."⁴⁰ In addition, Southern must also file the results of its investigations of abandoned coal mines and ensure that the pipeline is designed to withstand stresses caused by subsidence in these areas.

c) *Caves*. The caves found along the pipeline route caused concerns for the possible threatened and endangered bats that could be inhabiting them. Southern was required to examine the latest available information from the Alabama Cave Survey to determine if these caves are along the route and whether they are inhabited. Also, the previously-mentioned geologist should be consulted concerning the subsurface extent on the nearby caves.

d) *Land Disturbance*. The proposed project would result in the disturbance of 1,200 acres of land, 500 acres of forested land, and forty acres of wetland. Only approximately half of these areas will be temporary work areas and allowed to return entirely to their previous conditions. The remaining areas would be cleared for permanent right of ways; however, it was concluded that Southern's procedures⁴¹ and mitigation measures would prevent significant long-term impacts.

The FEIS commented on the environmental impacts of other route variations, but it was concluded that "there are no reasonable alternatives which avoid . . . areas of similar or significantly greater environmental impact and/or provide major engineering obstacles to the construction of the project."⁴²

38. *Id.*

39. FEIS, *supra* note 37, at 7-1.

40. *Id.*

41. Southern included in its final project plan Wetland and Waterbody Construction, and Mitigation Procedures that were intended to minimize the extent and duration of project-related disturbance of wetlands and waterbodies. A few examples of these mitigation measures are as follows: since the pipeline will disturb a significant amount of land, Southern will file with the Secretary a copy of its Stormwater Pollution Prevention Plan; and Southern will also employ at least two environmental inspections per construction spread. FEIS, *supra* note 37, at A-5.

42. FEIS, *supra* note 37, at 7-5.

III. ANALYSIS

The majority of the court's opinion was spent addressing Midcoast's argument that claimed that the FERC acted outside of its discretion in granting Southern, instead of the environmentally superior Alabama-Tennessee Alternative, a certificate of public necessity and convenience for its North Alabama Pipeline Project. Another issue Midcoast heavily contested was the manner in which the FERC applied its Pricing Policy to Southern's project. A less controversial topic was the argument presented by GASP and CONAPP that the FERC had granted Southern the power of eminent domain, which is a violation of the Fifth Amendment to the United States Constitution. The court concluded that the FERC neither acted capriciously nor misapplied its Pricing Policy, and that Southern's project had sufficient public purpose to justify the granting of eminent domain.

A. FERC's Granting Southern's Proposal was Arbitrary and Capricious

Midcoast asserts that the FERC's decision to grant Southern's certificate for the North Alabama Pipeline Project was arbitrary and capricious for two reasons. First, the agency failed to adequately evaluate alternatives to the project that would be more environmentally friendly, as well as economically preferable. Second, Midcoast claims the record does not support the FERC's conclusion that Southern's proposal would promote competition in the natural gas market.⁴³

In response to Midcoast's allegation that the FERC did not adequately investigate environmentally superior alternatives to the proposed project, the court looked to the FERC's Certificate Order granting Southern's proposal, which acknowledged the environmental consequences and superior alternatives to the North Alabama Pipeline Project. The Certificate Order also addressed the comments and suggestions made to the FERC in the FEIS, stating that Southern's project would only have "limited adverse environmental impact if constructed as planned, and with the mitigation measures identified in the FEIS."⁴⁴

Under NEPA, Southern was required to include in its project proposal an EIS, which the FERC was then required to review before granting a certificate for the proposed project.⁴⁵ The standard of review for this EIS required by the FERC, is only that it take a "hard look" at the environmental effects of its decision and include environmental consequences in its balancing process.⁴⁶ However, these environmental mitigation measures are merely recommendations and are not meant to impose a substantive duty on agencies. This standard was established in the precedential case

43. Midcoast Interstate Transmission, Inc. v. FERC, 198 F.3d 960, 967 (D.C. Cir. 2000).

44. Order Issuing Certificate, *Southern Natural Gas Co.*, 79 F.E.R.C. ¶ 61,280, at 62,203 (1997).

45. 42 U.S.C. § 4332 (1994).

46. *Corridor*, 166 F.3d at 374.

by the Supreme Court, *Robertson v. Methow Valley Citizens Council*,⁴⁷ which held that:

Although the EIS requirement and NEPA's other "action-forcing" procedures implement that statute's sweeping policy goals by ensuring that agencies will take a "hard look" at environmental consequences and by guaranteeing broad public dissemination of relevant information, it is well settled that NEPA itself does not impose substantive duties mandating particular results, but simply prescribes the necessary process for preventing uninformed—rather than unwise—agency action. While a reasonably complete discussion of possible mitigation measures is an important ingredient of an EIS, and its omission therefrom would undermine NEPA's "action-forcing" function, there is a fundamental distinction between a requirement that mitigation be discussed in sufficient detail to ensure that environmental consequences have been fairly evaluated and a substantive requirement that a complete mitigation plan be actually formulated and adopted.⁴⁸

The FERC concluded that other factors outweighed what the FEIS described as the project's limited, but nonetheless acceptable, environmental costs if specified mitigation measures were taken. These other factors are discussed throughout the remainder of the article.

The FERC has an obligation to weigh all relevant factors in exercising its responsibilities under the NGA and in making its final determination whether a project is in the public interest. Midcoast argues that "the finding that Alabama-Tennessee's System Alternative is environmentally preferable demonstrates that Southern's proposal is not in the public convenience and necessity."⁴⁹ Nonetheless, as discussed above, NEPA recognizes that the environmental factor is only one of many to be considered by the FERC when granting certificates. Midcoast also claimed that its proposed alternative would economically benefit the Cities, more so than would Southern's proposal. However, in evaluating this, the FERC found that the Cities would actually benefit more through Southern's project since: "Southern's single integrated pipeline system eliminates the complexities and problems of contracting and scheduling service through two pipelines. . . ."⁵⁰ The court deemed this "responsible agency decision making."⁵¹

Midcoast also argued that the FERC failed to show sufficient support that Southern's proposal would promote competition in the natural gas market. In responding to this allegation, the courts relied heavily on the fact that given the choice between a new and existing supplier, the Cities themselves chose to abandon Midcoast and sign a long-term contract with Southern. In *Kansas Power and Light Co. v. FERC*,⁵² the Commission based its decision to allow bypass on a long-standing policy of favoring competition in natural gas markets and a belief that "competition best

47. *Robertson*, 490 U.S. 332.

48. *Id.* at 333.

49. 79 F.E.R.C. ¶ 61,280, at 62,208.

50. *Id.* at 62,210.

51. *Midcoast*, 198 F.3d at 968.

52. *Kansas Power and Light Co. v. FERC*, 891 F.2d 939 (D.C. Cir. 1989).

serves the public interest.”⁵³ The FERC has applied this belief to the case at hand, stating that “in a competitive market environment, the parties are at risk for their own decisions, and the need to provide competitive services is the factor that leads to improved service at lower cost for consumers.”⁵⁴

Order No. 636 was implemented with the purpose of furthering the movement to a more competitive market in the Natural Gas Act. The FERC felt that competition would benefit all gas consumers by ensuring an adequate and reliable supply of natural gas. Order No. 636 has two goals: the first is to ensure that all shippers have meaningful access to the pipeline transportation grid, and the second is to ensure consumers access to an adequate supply of gas at a reasonable price.⁵⁵ Although Alabama-Tennessee claimed that granting Southern’s proposal would be anti-competitive, the FERC found the opposite to be true. It found that it would be introducing competition into a market for the first time in forty-seven years by offering the Cities a choice in their supplier of natural gas. This belief was supported by *United States v. El Paso Natural Gas Co.*⁵⁶ The *El Paso* case was similar in that it too dealt with a new natural gas supplier being introduced in a monopolized market. The court concluded that “the effect of competition in a particular market through acquisition of another company is determined by the nature and extent of that market and by the nearness of the absorbed company to it, that company’s eagerness to enter that market, its resourcefulness, and so on.”⁵⁷ The FERC felt that Alabama-Tennessee had ample opportunity to compete with Southern for the business of the Cities. Alabama even offered to lower its current rates. Despite this attempt to retain their business, the Cities still chose to sign a contract with Southern.

B. The FERC’s Decision to Establish a Presumption of Rolled-in Rates was Erroneous

Midcoast argued that the FERC’s decision to establish a presumption for rolled-in rates was erroneous for two reasons: first, the Pricing Policy is not applicable to cases such as this that involve questions of fair competition; and second, (even if the policy does apply to competition cases) Southern’s project did not meet the policy’s criteria for rolled-in pricing.⁵⁸

Midcoast’s argument that the Pricing Policy does not apply is limited to situations where pipelines of disparate size are competing to serve a particular market. Midcoast maintains that application of the Pricing Policy will distort market realities because large pipeline systems can readily ab-

53. *Id.* at 941.

54. *Kansas*, 891 F.2d at 941.

55. Order Issuing Certificate, *Southern Natural Gas Co.*, 79 F.E.R.C. ¶ 61,280, at 62,210-11 (1997).

56. *United States v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).

57. *Id.* at 660.

58. *Midcoast*, 198 F.3d at 970.

sorb the rolled-in cost of new projects.⁵⁹ However, the court held that Midcoast's argument overlooked the main purpose of the Pricing Policy, which is to "provide the industry with as much upfront assurance as is possible with respect to the rate design to be used for an expansion project, while at the same time, to provide for a flexible assessment of all the relevant facts of a specific project."⁶⁰ As a result of implementing Order Nos. 436 and 636, a new market was created and the FERC felt the Pricing Policy should be more attuned to these market realities. It was unanimous among FERC commentators that companies needed to know the rates they will face prior to making a decision to commit to a long-term contract. Such certainty could best be provided through upfront determination.⁶¹ In determining what changes to make to the Pricing Policy, the FERC made no mention of competition nor any reference to the policy not being applicable to cases dealing with competition, as Midcoast claimed. The FERC fully addressed Midcoast's argument with the facts stated above, and the court could find no reason to doubt the FERC's conclusion. Furthermore, it was reasoned by the court that it had no authority to override the FERC's decision, "the scope of review under the 'arbitrary and capricious' standard is narrow and the court is not to substitute its judgment for that of the agency."⁶²

Midcoast further alleged that if the policy could be applied to this case, as it obviously can, the FERC misapplied it. Midcoast claimed that Southern did not meet the criteria for rolled-in pricing.

The question of how to allocate costs among pipeline's customers is a difficult issue of fact, and one on which the Commission enjoys broad discretion . . . and when the FERC determines that rolled-in pricing is warranted it must outline with reasonable particularity the system-wide benefits that each new facility produces.⁶³

In order to determine if a proposed project warrants the use of rolled-in pricing, the FERC first looks to the extent to which the new facilities are integrated with the existing facilities, and to the specific system benefits produced by the project. "The pipeline seeking rolled-in pricing must specifically identify the system benefits, describe the value of the benefits to its existing customers, and demonstrate, with particularity, how the proposed project will provide the claimed benefit."⁶⁴ Second, the FERC looks at system benefits against the "five-percent" prong test to determine rolled-in pricing.

To determining whether rolled-in pricing is appropriate, the system benefits of the project must be analyzed in context with the rate increase to existing

59. *Id.*

60. *Pricing Policy for New and Existing Facilities Constructed By Interstate Natural Gas Pipelines*, 71 F.E.R.C. ¶ 61,241, at 61,915 (1995).

61. *Id.*

62. *Motor Vehicles Mfrs. Ass'n of the United States v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

63. *Algonquin Gas Transmission Co. v. FERC*, 948 F.2d 1305, 1313 (D.C. Cir. 1991).

64. 71 F.E.R.C. ¶ 61, 241, at 61,916.

customers produced by rolled-in pricing. The Commission will apply a presumption in favor of rolled-in rates when the rate increase to existing customers from rolling-in the new facilities is 5% or less and the pipeline makes a showing of system benefits.⁶⁵

This presumption is made in situations, such as this, where the service the new customers will receive is similar to that provided to existing customers and where rolling-in the incremental costs will not significantly increase the average rates. Incidentally, none of Southern's customers whose rates would be affected objected to this decision. It was found that in a worst-case scenario, rolling-in these facilities' costs would result in a rate increase to existing customers of only 0.4%. Therefore, since Southern's rate impact was found to be *de minimis*, it was not even required to show extensive benefits in order to justify rolled-in pricing. Despite the lack of necessity, Southern did present the FERC with four operational benefits its existing customers would gain from the project: 1) the addition of 4700 hp of mainline compression represents a significant enhancement of system reliability; 2) this compression will result in an increase in the availability of interruptible transportation service since the capacity may be available to existing shippers if it is not being used by expansion shippers; 3) new opportunities for marketers and shippers are available on the Southern system; and 4) firm service is provided for increased shipments to the Cities by two Southern system shippers.⁶⁶

In order for Southern's cost/benefit analysis to properly reflect the level of system benefits for its project, the FERC had to adjust its cost/revenue studies. This adjustment was done in response to a concern expressed by the cities of Atlanta and Chattanooga. The FERC was concerned about Southern's use of two different percent rates of return. Atlanta and Chattanooga stated that had Southern used a 10.77% rate of return for the proposal, the cost of service would increase by such an annual rate that the system benefits would be either greatly reduced or reversed. The FERC agreed with these concerns. Southern was using its 9.25% overall rate of return, which is project specific, instead of the system rate of return approved by the FERC, which is 10.77%.⁶⁷ This seemingly minuscule adjustment resulted in a decrease in the projects long-term benefits from Southern's estimated thirty million dollars to the actual twenty-five million dollars determined by the FERC. Also, it was determined from this cost/revenue adjustment that the estimated incremental cost of service for the proposed facilities is greater than the revenues Southern estimated it would receive.

Another argument Midcoast offered to show that Southern did not qualify for rolled-in pricing was the claim that "Southern's proposed pipeline was a 'downstream lateral for the benefit of one or only a small num-

65. *Id.*

66. Preliminary Determination, *Southern Natural Gas Co.*, 76 F.E.R.C. ¶ 61,122, at 61,638 (1996).

67. 76 F.E.R.C. ¶ 61,122, at 61,638.

ber or customers.”⁶⁸ Downstream lateral systems generally do not qualify for rolled-in pricing under the policy because they benefit only a small number of people and other shippers will not share in the benefits. The FERC’s response to Midcoast’s argument was rather brief; it simply stated that “Southern’s system generally consists of two parallel mainlines with fifteen mainline extensions totaling near 1350 miles and serving sixty-six firm shippers at 196 delivery points. The proposed facilities are similar to Southern’s other mainline extensions that have been granted rolled-in rate treatment.”⁶⁹ The FERC also noted that Southern’s project satisfied both parts of the two-prong test for determining rolled-in rates. The project was deemed to increase rates by less than five-percent and it demonstrated system wide benefits. The FERC based its argument on this reasoning. It pointed out that it did not base its decision on the fact that the North Alabama Project was similar in nature to other projects of Southern’s that have been granted rolled-in pricing. The court felt the FERC’s response was lacking in any real significance; nonetheless, it also noted that there was ample evidence to support Southern’s fulfillment of the two-prong test and the court again recognized the agency’s authority to use their discretion. Therefore, Midcoast’s argument was dismissed.

C. Dismissal of Alabama-Tennessee & Hartselle Alternatives was Unreasonable

Midcoast felt that the FERC’s dismissal of the Alabama-Tennessee and Hartselle Alternatives was unreasonable and an abuse of discretion. However, based on ample evidence that supports the FERC’s decision, the court did not agree with Midcoast. Midcoast presented the FERC with a proposal for the Alabama-Tennessee Alternative that was intended to serve as a complete alternative to Southern’s North Alabama Project. Midcoast’s application was filed following the FERC’s issuance of its draft environmental statement. However, action was deferred on Midcoast’s proposal:

because Midcoast had not provided any market support for its Alabama-Tennessee System Alternative project in that the three shippers the project was intended to serve had executed service agreements with Southern, and two of the shippers, Decatur and Huntsville, filed protests to Midcoast’s application requesting the Commission to deny the application due to lack of market support. The Commission further noted that Midcoast had not held an open season for the capacity to determine the correct sizing of the proposed construction project.⁷⁰

In deciding whether to grant a certificate of convenience and necessity, the FERC gives preference to those companies that have conducted an open season. During an open season, the pipeline posts the proposed project, allows all potential shippers to submit their capacity requests, and

68. *Midcoast Interstate Transmission, Inc. v. FERC*, 198 F.3d 960, 971 (D.C. Cir. 2000).

69. 76 F.E.R.C. ¶ 61,122, at 61,638.

70. Order Dismissing Application, *Midcoast Interstate Transmission*, 83 F.E.R.C. ¶ 61,195, at 61,827 (1998).

employs a non-discriminatory method of allocating the available capacity. Based on Midcoast's failure to do this, its application was denied.

The Hartselle Alternative was proposed by Midcoast because it felt Southern's proceedings did not find or recommend a viable route across the Wheeler Wildlife Refuge. The Hartselle Alternative was intended to replace the last leg of Southern's project. Midcoast suggested that Southern build the first ninety-eight miles of the proposed pipeline and Midcoast build the remaining eight miles that would lead to Midcoast's existing Hartselle Lateral. Midcoast claims the Hartselle Alternative meets the FWS standards for crossing the refuge and was, therefore, more environmentally friendly than the proposed North Alabama Pipeline Project. However, when this application was presented to the FERC, it was missing the required environmental report, as well as a showing of market support. The FERC informed Midcoast that its application was lacking these required items. Midcoast responded by submitting an environmental report, but the report was still incomplete. The environmental report Midcoast submitted did not contain an efficient environmental analysis; for example, it did not indicate the size of the right of way for the replacement portion of the project, nor did it make any mention of impacted wetlands or streams. Upon submitting an application, certain types of market data "must accompany each application when tendered for filing."⁷¹ This data must include a "conformed copy of each contract, letter of intent, or other agreement for sale or transportation of natural gas proposed by the application."⁷² Midcoast had no contracts, and Southern stated that it did not intend to do business with Midcoast, nor did the Cities or their customers. In a situation where no agreement exists, the company is obligated to explain its "basis for assuming that contracts will be consummated and that service will be rendered under the terms contemplated in the application."⁷³ Midcoast failed to provide this information, which resulted in the FERC dismissing its application.

D. GASP and CONAPP Claim Lack of Public Interest

GASP and CONAPP are two unincorporated associations that are opposed to the North Alabama Pipeline Project, due to concern for the environmental aspects of natural gas pipeline regulation. GASP and CONAPP argue that the promotion of competition in natural gas markets is not a legitimate public interest sufficient to justify the condemnation of the land required for the pipeline's right of way. Also, they claim that Southern's taking of private property is not constitutional because competition will not actually be achieved by the FERC's substitution of one natural gas monopoly for another.⁷⁴

71. 18 C.F.R. § 157.14(a) (1999).

72. 18 C.F.R. § 157.14(a)(11)(v).

73. *Id.*

74. *Midcoast*, 198 F.3d at 973.

The Fifth Amendment to the Constitution states that "nor shall private property be taken for public use, without just compensation."⁷⁵ However, the court concluded that as long as some public purpose was served, the Constitution would be satisfied. This finding was based on *National Railroad Passenger Corp. v. Boston & Maine Corp.*,⁷⁶ which held that "the public use requirement of the Takings Clause is coterminous with the regulatory power, and that the Court will not strike down a condemnation on the basis that it lacks a public use so long as the taking is rationally related to a conceivable public purpose."⁷⁷

Therefore, it is not necessary to make a factual determination as to whether the condemnation of property will actually result in its objected activity. In defense of its use of eminent domain, Southern also relied on section 717f(h) of the NGA, which states:

when a holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of the property to the compensation to be paid for ⁷⁸ it may acquire the same by the exercise of the right of eminent domain

Since this statute clearly grants the certificate holder the power of eminent domain, the FERC lacks the authority to withhold it.

IV. FUTURE IMPLICATIONS

A. *Environmental Impact*

Although Southern was granted permission to launch its North Alabama Pipeline Project in accordance with the mitigation measures, there are inevitably going to be some negative environmental effects as a result. Based on the environmental concerns alone, the question almost begs to be asked: "What if Midcoast had only done an open season?" As previously mentioned, the main reason Midcoast's Alabama-Tennessee Alternative was rejected by the FERC was that it did not hold an open season prior to submitting its application. Had Midcoast conducted an open season, it is reasonable to conclude that the Alabama-Tennessee Alternative would have been chosen over Southern's North Alabama Pipeline based on environmental superiority. The basis for such an assumption is the conclusions set out in the FEIS and the amended version of the FEIS.

When Southern applied to the FERC for its certificate of convenience and necessity, it had to submit an EIS. The EIS also made comments on the proposed alternatives to Southern's project. It was determined by the FEIS that based "solely on an environmental standpoint the Alabama-Tennessee System Alternative is preferred."⁷⁹ The Alabama-Tennessee

75. U.S. CONST. amend. V.

76. *National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407 (1992).

77. *Id.* at 1404.

78. 15 U.S.C. § 717f(h) (1994).

79. Fed. Energy Regulatory Comm'n, FERC No. 0109F, Docket Nos. CP96-153-000 and CP97-343-000, Final Environmental Statement: North Alabama Pipeline Project, at 6-3 (May 1997).

Alternative would only have required the installation of three compressors, totaling 5,724 horsepower, at three existing compressor stations. Whereas, the North Alabama Pipeline required the construction of 126.6 miles of pipeline, two new meter stations, and a total of 6,300 horsepower at two existing compressor stations.⁸⁰ These differing requirements demonstrate how much less construction and disruption would have occurred had Midcoast's proposal been approved. Since Midcoast's facilities could have been installed at existing sites, no additional land would have been required or converted to industrial use.⁸¹ In contrast with this, the North Alabama Pipeline Project altered 1,200 acres of land, with 680 acres of this permanently used as right of way for the pipeline. In addition, the FEIS identified twenty-three federally listed endangered or threatened species that would have been found in the proposed project area of the North Alabama Pipeline. One in particular is the flattened musk turtle. The FWS determined Southern's handling of the turtle as a "take"⁸² under section 9 of the Endangered Species Act (ESA).⁸³ Had the Alabama-Tennessee Alternative been implemented, no federally listed threatened or endangered species would have been directly disturbed.

Following the issuance of the FEIS, Southern was required to adjust its proposed project to conform to the mitigation measures set out in the FEIS. Although Southern conformed to the mitigation measures in an attempt to make its project less of an environmental burden, it was unsuccessful in surpassing Midcoast's proposal in environmental quality. The amended FEIS was released in June of 1998, and it also concluded that Midcoast's project was "still environmentally preferred over the proposed project and all of the other alternatives examined in the FEIS and this Supplement."⁸⁴

B. Pricing Policy

The main difference between the new Pricing Policy and the old Pricing Policy (both of which are discussed in detail above) is the fact that under the new Pricing Policy, the main prerequisite for being granted a certificate of public convenience and necessity is that the project must be able

80. *Id.*

81. FEIS, *supra* note 37, at 6-1.

82. "Take" has been defined by the Act as to "harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any such conduct." ESA, 16 U.S.C. § 1532(19) (1994).

83. FEIS, *supra* note 37, at 7-2. Section 9 of the ESA states in pertinent part:

Except as provided in sections 1535(g)(2) and 1539 of this title, with respect to any endangered species of fish and wildlife listed pursuant to section 1533 of this title it is unlawful for any person subject to the jurisdiction of the United States to . . . take any such species within the United States or the territorial sea of the United States. . . .

16 U.S.C. § 1538.

84. Fed. Energy Regulatory Comm'n, Docket No. CP96-153-004, Amended North Alabama Pipeline Project, Final Supplement to the Final Environmental Impact Statement, at 3-2 (October 1998).

to stand on its own financially, meaning it has to be financially stable without any subsidization from its existing customers. This change in policy eliminates the five-percent presumption for rolling-in rates on a project, which Southern relied on in pricing the North Alabama Project. It has been decided that the new Pricing Policy would not apply retroactively and would therefore only apply to projects filed after July 29, 1998. Although Southern's project filed for a certificate in 1996 and was certified in 1997, the new Pricing Policy was still brought before the judges in oral arguments. The project's opponents filed to bring the new Pricing Policy before the judges as proof that "the public benefits examination undertaken by the FERC relative to Southern's pipeline proposal was fundamentally flawed."⁸⁵ Yet another filing by the project opponents stated that the policy statement "provides further support for—indeed confirms—the arguments" that had been made in the case.⁸⁶ These motions were rebutted with a motion to strike, since the policy clearly states that it will not be applied retroactively; nonetheless, the judge denied the strike motion.

Obviously the new Pricing Policy was not applied to Southern's Project since it already had its certificate when the policy was enacted; however, I think it can be concluded that had the new policy been implemented here, the North Alabama Pipeline would have never been built. At the oral arguments mentioned above, a Washington attorney stated that if the FERC had approved incremental pricing under the new policy for the project, "it would have been uneconomical and would never have been built."⁸⁷ The new Pricing Policy also offers more support for the arguments made by the GASP and the CONAPP. Counsel who represented the GASP stated that "the policy statement is a 'huge win for landowners.'"⁸⁸ He claimed that under the new policy, "pipelines now will have to deal with landowners earlier in the process, which presents a 'whole different dynamic.'"⁸⁹ Had more weight been given to the arguments of the GASP and the CONAPP, it would have been discovered that "Congress never intended to vest the power of eminent domain in a certificate holder in a case such as this."⁹⁰ It was contended that when Congress amended the NGA in 1947 to give certificate holders the power of eminent domain, it was done in response to Railroads creating impediments to construction because they were threatened by the use of coal as a power source.

85. Larry Foster, *New Certificate Policy Crops up in Appeal of North Alabama Project*, INSIDE FERC, Sept. 27, 1999, at 1.

86. *Id.*

87. Foster, *supra* note 85, at 1.

88. *Id.*

89. Foster, *supra* note 85, at 1.

90. *Pipeline Projects, Landowner Groups Press Eminent-Domain Issue In Southern Natural-Appeal*, INSIDE FERC, May 10, 1999, at 9.

The underlying rationale for the new Pricing Policy is to let the market decide which projects should be built. Also, the new policy hopes to prevent existing customers from having to subsidize a project that does not serve them, as well as to enable landowners to forgo being subjected to the power of eminent domain for a project that is not financially viable. "FERC must be required to explicitly find that 'the property owners interests are less deserving of protection than the pipeline's interest in penetrating a market already receiving natural-gas service.'"⁹¹ This requirement was not met. Southern's project had a total annual cost of service of \$18.4 million and a revenue of \$9.6 million, meaning the project shippers would be paying for 52% of the costs. This fact led to the argument that "construction and operation of that project will bring higher costs—not benefits befitting the public interest—to consumers."⁹² Had the new policy been applied to Southern's project, I believe that it would not have been built. The only dependable support there would have been for Southern's project is the huge amount of market support it had. However, market support is but one element among many to be considered by the FERC when granting a certificate. Under the new Pricing Policy, the two main requirements are that the project be able to stand on its own financially and that there is a sufficient showing that the applicant has made efforts to minimize any adverse effects. There is ample evidence that Southern would have been unable to meet these requirements.

V. CONCLUSION

The North Alabama Pipeline Project was completed at the beginning of the year and put into service on the seventh day of January, 2000. Despite all the controversy that was caused by this project, the FERC still resolved that the project served the public's benefit. It was concluded that although there were environmentally superior alternatives to the North Alabama Pipeline, that since the project was to be completed according to the mitigation measures, the environmental impacts would be limited and controllable.

Southern was also granted rolled-in pricing for its project because it successfully met the FERC's two-prong test. The first prong is to show that the project will provide system wide benefits and the second is to qualify for the five-percent presumption. To qualify for the five-percent presumption the rate increase to existing customers from rolling-in the cost of the new facilities has to be five-percent or less. Southern succeeded in providing evidence of four system wide benefits that the project would realize, and its rate increase was predicted to be only 0.4%, which is well within the five-percent limit. However, had the proposal for the North Alabama Project been made only three years later, the new Pricing Policy would have been applied. It has been argued that Southern would not have been able to meet the requirements of this policy and the pipeline

91. *Id.* at 9.

92. Foster, *supra* note 85, at 1.

may not have even been built. Thus, it can be concluded from the lengthy litigation of this case that there are many elements to be considered when determining whether a specific project is going to benefit the public and these elements are constantly changing as new environmental, economic, and technical concerns arise.

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