

*Report of The
Research and Development Committee*

RECENTLY, THE FERC has taken action in three significant cases involving its research, development and demonstration (RD&D) regulations and policy:

(1) In Opinion No. 64, *Gas Research Institute*, Docket No. RP79-75, issued October 2, 1979, the Commission approved Gas Research Institute's 1980 Research and Development Program and Related Five-Year Plan.

(2) In Opinion No. 69, *Great Plains Gasification Associates, et al.*, Docket Nos. CP78-391, *et al.*, issued November 21, 1979, the Commission issued a certificate of public convenience and necessity facilitating the construction and operation of the first commercial-size, high-Btu coal gasification plant in the United States and found that the Great Plains project qualified as a demonstration project under the Commission's RD&D regulations.

(3) In *Texas Eastern Transmission Company*, Docket No. RP79-81, Order Denying Petition for Advance Approval, issued February 28, 1980, the Commission determined that the "Tuscoal Project," designed to demonstrate the commercial feasibility of producing natural gas from coal seams, though a worthwhile venture, was not the type of commercial demonstration project which warrants special rate treatment pursuant to the Commission's RD&D regulations.

Together, these three cases represent the FERC's current posture on the RD&D proposals; and the first two have given rise to basic challenges to the Commission's RD&D jurisdiction. Below, each of these cases will be discussed in some detail.

GAS RESEARCH INSTITUTE

In Opinion No. 64, the FERC granted Gas Research Institute's (GRI) third annual application for approval of its proposed research and development activities and the funding thereof through qualifying interstate, wholesale natural gas rates and transportation charges. In granting GRI's application, the Commission approved GRI's 1980 Research and Development Program and 1980-1984 Five-Year Plan with minor exceptions, and it found a 1980 GRI funding requirement of \$55,395,000 to be just and reasonable. Reducing this funding requirement to a uniform charge to be applied to GRI's 1980 program funding services of 11,486 Bcf, the Commission permitted the collection of a GRI charge of 4.8 mills per Mcf through jurisdictional rates and charges applicable to qualifying sales transportation services rendered by GRI member pipelines. Consistent with the Commission's determination, the GRI member pipelines have made tariff filings necessary to place the 4.8 mill charge in effect commencing January 1, 1980.

Commentary on the GRI filing came from a variety of sources and included a comprehensive report filed by the FERC Staff, an analysis of GRI's application prepared by the Department of Energy's Energy Research Advisory Board (ERAB) and pleadings filed by the People of the State of California and the Public Utilities Commission of the State of California (California), the Public Utilities Commission of the State of Colorado

(Colorado) and the Ridge Street Neighborhood Association (Ridge Street), an *ad hoc* group identified as representing low income consumers located in Charlottesville, Virginia.

The reports filed by both the FERC Staff and ERAB analyzed GRI's application in depth, made many recommendations for implementation in the pending and future GRI proceedings, and recommended approval of GRI's application. Most of these recommendations were adopted by the Commission in Opinion No. 64. One such recommendation, made by the FERC Staff, led to a further analysis of GRI's administrative and general costs and a direction to Staff that an additional report be prepared addressing the causes of A&G cost increases and proposing means of controlling such increases.

California made three major substantive recommendations concerning the content of GRI's application: (1) that GRI maximize its efforts to obtain manufacturer co-funding for its projects, (2) that GRI's efforts to develop economic means to produce hydrogen be accelerated, and (3) that GRI place a higher priority on environmental research related to its supply enhancement activities. California's comments generally went to the content of future GRI RD&D activities and GRI has agreed to bring them to the attention of its planning bodies for use in designing future programs.

In its petition to intervene in the GRI proceeding, Ridge Street alleged that the GRI application failed to satisfy the Commission's RD&D Regulations especially in failing to provide for adequate consumer representation. The FERC found Ridge Street's allegation to be unfounded but reiterated its requirement that consumer representation on GRI's advisory bodies not only be maintained, but that such representatives be provided every opportunity for meaningful participation.

Colorado raised two separate challenges to FERC's jurisdiction with regard to GRI applications. First, Colorado asserted that GRI is not a "natural gas company" within the meaning of the Natural Gas Act and, therefore, the Commission has no jurisdiction to entertain GRI's annual applications. Secondly, Colorado argued that even assuming FERC jurisdiction to consider GRI's applications generally, nevertheless, the majority of the project areas covered by GRI's 1980 Program pertain to matters beyond the Commission's direct regulatory authority and, therefore, such project areas may not be funded through FERC jurisdictional rates. The Commission dismissed both of Colorado's jurisdictional arguments as invalid.

The Commission met the first of Colorado's contentions by noting that its current RD&D regulations, as set forth in Order No. 566,¹ grew out of a regulatory history of authorizing and encouraging industry-wide research and development activities in the natural gas industry. The Commission went on to indicate that notwithstanding the fact that it is GRI, as an "RD&D organization," which files annual applications for advance approval with the Commission, the legal effect of such approval, if extended, is to authorize

¹Order Prescribing Changes in Accounting and Rate Treatment for Research, Development and Demonstration Expenditures, Docket No. RM76-17, issued June 3, 1977.

individual company contributions to the "RD&D organization" involved. Thus, the Commission reasoned that its unquestioned jurisdiction over GRI's individual jurisdictional members pursuant to the Natural Gas Act, especially Section 4 thereof, gave it a sufficient jurisdictional basis for acting upon GRI's applications, which are in effect joint requests by GRI's jurisdictional pipeline members for advance rate and accounting approval of their contributions to GRI.

As to Colorado's second point, the Commission determined that approval of a surcharge on rates which are clearly jurisdictional, even though for the purpose of funding RD&D activities which might lead to applications outside the Commission's direct regulatory jurisdiction, is nonetheless permissible so long as such Commission action is designed to ensure adequate service to natural gas consumers. The Commission cited judicial precedent for the proposition that the Commission's jurisdiction over rates includes the authority to determine the reasonableness of costs incurred, even though such costs themselves relate to matters beyond the Commission's direct control.

Colorado continues to press its jurisdictional challenges on rehearing. As evidenced by its notice issued November 30, 1979, the Commission denied Colorado's application for rehearing, and on January 25, 1979, Colorado filed its petition for review with the United States Court of Appeals for the District of Columbia Circuit. The case, styled *Public Utilities Commission of the State of Colorado v. F.E.R.C.*, D.C. Cir. No. 80-1117, is currently pending in the Court, and briefing has been completed.

GREAT PLAINS GASIFICATION ASSOCIATES

In Opinion No. 69, the FERC reversed the initial decision of the Presiding Administrative Law Judge and issued a certificate of public convenience and necessity to Great Plains Gasification Associates, authorizing sales for resale in interstate commerce to five pipeline companies of equal volumes of commingled natural and coal gas, equivalent on a Btu basis to the output of the Great Plains Coal Gasification plant, less line losses. In so doing, the Commission acted to make financing of the Great Plains plant feasible through a series of certificate and rate conditions predicated in part upon the Commission's treatment of the project as an RD&D project under the Commission's regulations qualifying for unconventional rate treatment.

The Great Plains project, proposed to be the first commercial-size, high-Btu coal gasification plant in the United States, is designed to produce 125,000 Mcf per day of pipeline quality gas from lignite reserves located adjacent to the plant in Mercer County, North Dakota. The capital costs of the coal gasification plant and associated coal mine were estimated to exceed one billion dollars. None of the parties to the proceeding objected *per se* to the construction and operation of the project. The principal focus of controversy became how the risks and costs of the project should be borne as among the project sponsors, taxpayers and gas consumers.

The Commission's extensive opinion covers all the issues common to a major certificate application including such public convenience and

ferenced Order No. 566. The Commission indicated that Order No. 566 contains a specifically stated rationale for deviating from the classic "used and useful" standard and that the project's qualification for the RD&D treatment established by Order No. 566 rendered GM's argument nugatory.

The intervenors which applied for rehearing have sought review of the Great Plains decision in the United States Court of Appeals for the District of Columbia Circuit. The case styled *Office of Consumers' Counsel, et al. v. Federal Energy Regulatory Commission*, D.C. Cir. Nos. 80-1306, *et al.* is pending in the Court. Briefing and oral argument have occurred under an expedited schedule, and the case is awaiting decision.*

THE TUSCOAL PROJECT

In its order denying Texas Eastern Transmission Company's request for advance rate and accounting treatment approval for its proposed \$3,484,000 expenditure associated with participation in the "Tuscoal Project," the Commission clarified its RD&D policy as it relates to activities designed to demonstrate the commercial viability of producing natural gas from non-traditional sources.

The project, aimed at testing the commercial viability of producing natural gas from coal seams located on acreage in Tuscaloosa County, Alabama, has a three-phase design: Phase I involving lease acquisition and test well site selection; Phase II devoted to the drilling and completion of four test wells, the hydrolic fracturing of encountered coal zones and the testing of reservoir permeability and system compressibility; and Phase III to be predicated upon favorable Phase II results, consisting of the drilling of and production from 92 additional wells.

The Commission's denial of Texas Eastern's request for advance approval of its proposal to recoup through wholesale natural gas rates Tuscoal project participation costs did not emanate from a lack of enthusiasm for the endeavor. Rather, the Commission's denial of Texas Eastern's request was based upon the Commission's determination that the proposal did not qualify as an "RD&D project" under the Commission's regulations.

The Commission's decision turns on the distinction between a commercial demonstration of the general viability of producing natural gas occluded in coal seams, an endeavor which would appear to be at least theoretically within the Commission's definition of a demonstration project, and, as such, qualifying for favorable rate and accounting treatment; and a commercially viable site-specific supply project, which must be financed through more conventional means.

In determining that Tuscoal did not qualify for RD&D project treatment and, therefore, that Texas Eastern's request for advance approval must be denied, two considerations were deemed important. First, the Commission concluded that the Tuscoal project was commercially viable without provision for special rate and accounting treatment. And, secondly, the FERC

*Editor's note—On December 8, 1980, the U.S. Court of Appeals issued its opinion setting aside the Commission's orders on a finding that the agency lacked statutory authority for its actions.

found that the results of the project were not likely to be of general applicability to coal seam production endeavors.

The Commission found lacking in the Texas Eastern proposal one of the essential features of demonstration projects which qualify for special rate and accounting treatment pursuant to the Commission's RD&D regulations, namely an apparent need to provide a special incentive, in the form of advance accounting and rate approval of project expenditures, in order to assure that the proposed activity is actually undertaken. Viewed as such, the Commission's decision is based upon an interpretation of its definition of an "RD&D project" which emphasizes that projects may qualify for the Commission's special rate and accounting treatment only so long as they are both technically *and* economically infeasible otherwise. This interpretation would appear to be a generally applicable clarification of the Commission's existing RD&D definition. The Tuscoal project was deemed economically feasible without RD&D treatment as evidenced by the proposed financing of seventy-five percent (75%) of the project costs by three other equal participants ostensibly utilizing conventional financing. The Commission also noted that the project's potential commercial viability without special incentive is supported by the NGPA's accord of deregulated pricing for production from coal seams. The Commission reasoned that the estimated cost of gas from the project, \$1.75 per Mcf, even if substantially understated, would be much more than covered by the deregulated price such production is anticipated to command. Given the NGPA's pricing incentive, the Commission determined that no additional incentives were required.

The Commission also questioned the qualification of the Tuscoal project for treatment as a demonstration project on the ground that the information potentially forthcoming from the endeavor did not appear to have major importance to coal seam gas production in general. Rather, the proposed project activities, taken as a whole, constitute a site-specific production effort utilizing existing technology, which, if successful, would be profitable to the participants and beneficial to gas consumers, but would do little to advance the state of the art of coal seam gas production.

COMMENT

Both the *Office of Consumers' Counsel* and the *P.U.C. of Colorado* cases, currently pending in the United States Court of Appeals for the District of Columbia Circuit, have the potential for providing a judicial test of the jurisdictional basis of the Commission's generally applicable RD&D policy and procedures. While it may be possible for the Court to dispose of these cases on other grounds, it appears likely that at least one of them will result in a determination on the merits of the jurisdictional challenges.

Both appeals raise a fundamental question as to the Commission's authority to allow recovery through jurisdictional rates of costs associated with RD&D activities designed to develop technology over which the Commission would have no jurisdiction. Since perhaps the majority of current gaseous fuels RD&D efforts are in this area, obviously the Court's decision

on this point could have large repercussions.

As to the implication of the *Tuscoal* decision, it is as yet unclear what impact, if any, it will have on the development of natural gas from non-traditional sources.

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