Report Of The Committee on Natural Gas Certificate And Authorization Regulations Under The Natural Gas Act

This report summarizes major developments during 1981 in the certification and regulation of pipeline companies and regulations covering independent producers of natural gas, pursuant to Section 7 of the Natural Gas Act, 15 U.S.C. § 717.

I. Regulation of Jurisdictional Pipeline Companies Under the Natural Gas Act

A. *Certification of New Pipeline Projects*

1. Ozark Gas Transmission System

In Opinion No. 125 issued July 28, 1981, in *Ozark Gas Transmission System*, Docket No. CP 78-532 (16 FERC ¶ 61,099), the Commission granted certification for the proposed construction and operation of a 455 mile pipeline project and related facilities. The Ozark Gas Transmission System (Ozark) is designed to transport 170,000 Mcf per day from the Arkoma Basin and West Stigler Field in Oklahoma on behalf of Columbia Gas Transmission Corporation (Columbia) and Tennessee Gas Pipeline Company (Tennessee) to a point of interconnection in White County, Arkansas, with the existing transmission system of Natural Gas Pipeline Company of America. Utilizing the transmission facilities of other interstate pipelines, the gas will be delivered to both Columbia and Tennessee through direct transmission, displacement and exchange agreements.

The Commission affirmed Presiding Administrative Law Judge Burton S. Kolko's Initial Decision in this matter (12 FERC ¶ 63,048) by rejecting Arkansas Louisiana Gas Company's (Arkla) claim that new interstate pipelines may not enter an area where there are existing pipelines unless it is first demonstrated that the existing pipelines are or will be unable to serve all requirements from the reserves available. The Commission concluded that certificate authorization for existing transmission lines would not guarantee freedom from competition. In addition, the Commission affirmed the Law Judge by finding that both Columbia and Tennessee had a superior need for gas in comparison to Arkla, and that Ozark's presence in the production area would not impair Arkla's ability to serve its existing customers.

In discussing Ozark's project financing proposal the Commission noted that in order to assure an income stream whether or not the project failed, Ozark's minimum bill was structured to yield sufficient revenues to cover debt service (both principal and interest payments). If the project failed, the minimum bill would be levied on the customers of the shippers in the form of a surcharge for gas they do not receive. The Commission indicated that in recent decisions approving project financing a key factor was its obligation under the Natural Gas Act to ensure a secure and long-term gas supply. The Commission also recognized both the risks that consumers were being asked to bear, as well as the benefits they would achieve under project financing.

The Commission determined that one appropriate standard for determining whether project financing is in the public interest would be a cost-benefit test — i.e., whether the probable benefits to consumers equal or exceed the probable costs. This determination, however, is complicated by several factors, including uncertainty as to how the Commission in the past treated post-completion, certificated abandoned assets; pre-completion, pre-certificated abandoned projects; and temporary interruption in service. Other questions involve the magnitude of deliverable reserves resulting from project success, the ability of project sponsors to finance the project, and whether some unique risk in and of itself justifies the shift of risks to consumers. This balancing of benefits and costs was looked at in terms of whether there was a reasonable expectation of sufficient gas reserves to satisfy the project.

The Commission found substantial record evidence to support a reasonable expectation of sufficient gas reserves to justify the project, and that the investment community will bank on such adequate reserves to support the pipeline. The Commission went on to note, however, that while Ozark had made a "marginal case" for project financing, "there were factors which allowed it to find that project financing of the pipeline was in the public interest." The Commission also made clear, however, that future requests for approval of project financing will undergo careful scrutiny.

In Opinion No. 125-A *issued on October 2, 1981,* (17 FERC ¶ 61,024), the Commission denied several applications for rehearing of its earlier issued opinion. The Commission affirmed the Law Judge's determination and its own prior opinion that the projected available gas supply was sufficient to support the project's construction and operation. With respect to rates, the Commission affirmed its prior determination of: (a) a modified minimum bill provision providing for a recalculation of the debt interest component of the demand charge to provide for recovery of actual debt interest paid during the pendency of initial rates; (b) a provision for a two year period of initial rates with the requirement to file a cost and revenue study not later than two years from the commencement of operations; (c) a modification of the commodity charge to be based upon an 87% load factor utilization during the period of initial rates; (d) a modification of the Law Judge's recommended rate of return from 13.5% to 14.34%; and (e) a depreciation rate of 6.67% during the period of initial rates.

On October 7, 1981, Arkla applied to the United States Court of Appeals for the District of Columbia Circuit for a stay of Opinion Nos. 125 and 125-A pending judicial review. On November 10, 1981, the Court denied the stay without prejudice to Arkla's reapplication after Arkla applied to the Commission for a stay and the Commission has ruled on the matter. On November 13, 1981, Arkla applied to the Commission to stay the effect of Opinion Nos. 125 and 125-A pending judicial review. On December 14, 1981, the Commission issued an Order Denying Stay (17 FERC ¶ 61,235) concluding that such stay would only restrain Ozark and others from competing with Arkla, would increase construction costs to the detriment of consumers, and that Arkla had failed to identify any adverse impact upon the environment as a result of the proposed project.

2. Trailblazer Pipeline Company

By an Initial Decision issued June 1, 1981, in *Trailblazer Pipeline Company, et al.*, Docket Nos. CP79-80, *et al.*, (15 FERC ¶ 63,046), Presiding Administrative Law Judge Stephen L. Grossman approved the proposed construction and operation of an integrated three-part transmission system which would extend approximately 800 miles from the Rocky Mountain Overthrust Belt Region to points of interconnection with the existing systems of Natural Gas Pipeline Company of America (Natural) and Northern Natural Gas Company (Northern) at or near Beatrice, Nebraska. The proposed pipeline would consist of three segments: Overthrust, Wyoming Interstate Co. (WIC) and Trailblazer. The design capacities of the three segments would be 40,000 Mcf per day in Overthrust, 665,000 Mcf per day in WIC and 525,000 Mcf per day in Trailblazer, respectively.

In the Initial Decision, the Law Judge conditioned certification of the Trailblazer project to require calculation of transportation rates based on certain minimum load factors. While noting a tremendous potential gas supply in areas accessible to the proposed Trailblazer System, the Law Judge found that the applicants had not yet acquired sufficient proven reserves to fill all or most of the proposed project capacity over a reasonably long economic life. In order to mitigate the potential risk to ratepayers of significant underutilization of pipeline capacity, the Law Judge required that commodity rates for each of the three Trailblazer segments reflect minimum throughput levels equivalent to 80% of free flow capacity in the first year of operations, 80% of design capacity in the second year, 85% of design capacity in the third year and 90% of design capacity in the fourth year and thereafter. The Law Judge determined that these minimum throughput levels would afford the applicants flexibility during the first few years of supply buildup in the Overthrust region as well as added flexibility over the longer term in light of the dependence of the Trailblazer System supply on processing plants of Amoco Production Co., Chevron U.S.A. Inc. and possibly other producers. Additionally, ratepayers would be insured some measure of protection if the pipeline were underutilized.

With respect to other major contested issues, the Law Judge approved project financing as proposed by the applicants, and accepted the applicant's two-part rate design (subject to modifications) including a demand charge set to recover interest and the debt-related portion of depreciation, all operating and maintenance expenses and all taxes exclusive of income taxes. He also adopted a 20-year economic life (and 5% depreciation rate) as recommended by Staff; and provided for a varying rate of return on equity depending on throughput levels. The equity return allowance would be 18% for each segment assuming annual throughput equal to 100% of design capacity. Depending on the segment, these returns would drop from between 15.2% and 15.6% assuming throughput levels equal to 90% of design capacity, to between 12.4% and 13.1% assuming throughput levels equal to 80% of design capacity. At an annual throughput equal to 80% of free flow capacity, equity returns would be 4% for the Overthrust segment, and 5% for the WIC and Trailblazer segments.

3. Pacific Offshore Pipeline Company

On March 17, 1981, the Commission issued in *Pacific Offshore Pipeline Company, et al.*, Docket Nos. CP74-35, *et al.*, (14 FERC ¶ 61,239A), an Order After Statutory Hearing Issuing Certificate of Public Convenience and Necessity and Amending Certificate With Conditions to permit Pacific Offshore Pipeline Company (POPCO) to construct and operate an offshore pipeline and related facilities from the Hondo Field, Santa Barbara Channel to onshore gas processing and treating facilities to be located in Santa Barbara County. The Commission's certification of the project was conditioned to require revision of POPCO's financing and tariff provisions, including capital structure, rate of return and initial rates.

In its order, the Commission concluded that POPCO's proposal did not fully reflect a "project financing approach." The Commission noted that while POPCO's type of tariff appears consistent with project financing, the proposed level of equity (47%) appeared excessive. Furthermore, POPCO's tariff allows full recovery of all debt, principal and interest costs. And the demand charge also allows recovery of all equity costs. The Commission concluded that a more appropriate capital structure would entail about 70% debt financing and 30% equity contributions.

On June 8, 1981, the Commission issued an order further clarifying and modifying certain conditions attached to the March 17, 1981 order certificating POPCO's project. (15 FERC ¶ 61,235). First, with respect to gas treatment and processing facilities, the Commission determined that Exxon would not be permitted to construct gas treatment facilities until POPCO's gas treatment facilities were operating at design capacity and that other liquid extraction operations conducted by Exxon would, when appropriate, require an apportionment of POPCO's cost of service. Second, with respect to gas which may be made available to POPCO by Exxon under an option agreement, the Commission limited Exxon's right to divert gas and extract liquefiable hydrocarbons from the gas stream delivered onshore through POPCO's facilities without authorization of the Commission. Third, the Commission indicated that the recovery of any production-related costs incurred by Exxon on behalf of POPCO would be subject to those pending proceedings before the Commission or the courts. Fourth, the Commission required Exxon to regenerate its take-or-pay provisions with POPCO to comply with the minimum 5-year make up period required by the Commission's regulations under 18 C.F.R. § 154.103. Fifth, the Commission determined that during the initial year of operation, POPCO should treat all costs and revenues as earnings and expenses during construction and record allowance for funds used during construction (AFUDC) in accordance with Part 201 Gas Plant Instructions 3(17) and 3(18). Further, the Commission ordered that a cost and revenue study be submitted within 30 days prior to the expiration of the initial year of operation demonstrating the appropriate rate for the second year, with POPCO bearing the burden of making this showing.

Sixth, the Commission clarified its prior order to indicate that POPCO was not precluded from seeking recovery of or on equity in the event of service interruption or abandonment which was beyond the control of prudent management. Seventh, the Commission modified its prior order with respect to depreciation and changed the rate to 5% to reflect a 20-year rather than 30-year project life, subject to future review. Eighth, the Commission modified its prior order to permit an interim rate of return on equity of 15% during construction and the first year's operation and permitted the recovery of debt in a manner consistent with the proposed tariff. For the period commencing with the second year of operation, a return on equity would be based on POPCO's actual financing costs. POPCO was also required to submit a debt financing report prior to completion of its permanent debt financing but not later than the filing of its tariff in order to secure Commission approval of the debt financing at that time. POPCO was also permitted to seek modification of these procedures if it so elected.

On November 4, 1981, POPCO filed its debt financing report requesting approval of the proposed financing plan, and a determination that the interest rates and formula by which such interest rates would be adjusted are reasonable and prudent, approval of its pro forma tariff and authorization for an equity return of 20% during the construction and operation of the project.

B. *Commission Policy Regarding Certificate Matters*

1. Certificate Jurisdiction

In a 1981 Natural Gas Act proceeding, the Commission relaxed its stand on a type of exchange of natural gas between a gathering company and an interstate gas pipeline company. In its order issued May 5, 1981 in *Southern Union Gas Gathering Company*, Docket No. CI81-22-000, (15 FERC ¶ 61,148), the Commission held that a gatherer is not required to be certificated for exchanges of equivalent volumes of gas with two interstate gas pipeline companies when the exchanges would take place on the parties' separate but "geographically proximate" gathering facilities. Granting Southern Union's petition for a declaratory order disclaiming certificate jurisdiction, the Commission held that the gathering company's participation in the exchanges was neither a sale nor transportation but gathering, under the exemption provisions of Section 1(b) of the Natrual Gas Act. The Commission thus abandoned its view that such exchanges constitute mutual sales by the parties. It also concluded that, although an exchange directly involving jurisdictional transmission facilities can fairly be said to be transportation of gas in interstate commerce, the exchange of gas at the wellhead or in gathering facilities constitutes gathering rather than transportation. The Commission characterized the gathering company's participation in the exchanges as a "surrogate" for what would otherwise be the construction and operation of redundant gathering facilities. In the Commission's words:

> [S]uch an exchange results in movement of gas volumes on behalf of both parties. When such "movement" would otherwise (absent the exchange agreement) be accomplished by the construction and operation of gathering lines, it is proper to view the exchange as being exempt under Section 1(b) of the NGA, just as the actual gathering facilities and operations would be exempt.

In a reversal of a prior order, the Commission ruled that when gas transportation may be authorized pursuant to either Section 7 of the Natural Gas Act or Section 311 of the Natural Gas Policy Act of 1978 (NGPA), the interstate gas pipeline applicant may seek authorization pursuant to either statute. *Tennessee Gas Pipeline Company*, Docket No. CP79-352 (order on rehearing issued July 10, 1981), (16 FERC ¶ 61,016). Tennessee applied in 1979 for a certificate pursuant to the Natural Gas Act authorizing the transportation of gas for fifteen years for Southern Connecticut Gas Company. The Commission instead granted Tennessee authorization for the transportation pursuant to Section 311(a)(1) of the NGPA. On rehearing, the Commission agreed with the applicant that since the proposed transportation would be in interstate commerce and subject to the jurisdiction of the Commission, the applicant could choose to seek authorization pursuant to either statute. The prior order was vacated, insofar as it granted Section 311 authorization, and was amended to issue a certificate under Section 7 of the Natural Gas Act. The Commission declined, however, to pre-grant abandonment of the transportation service, as was provided in the earlier NGPA authorization, saying that it could not determine now that the public convenience and necessity will be served by abandonment in the future in view of the long term. The Commission, notwithstanding this decision, noted that it continued to favor authorization pursuant to the NGPA where statutory authority overlaps.

2. NGPA Authorization

By its order issued on July 24, 1981 in *Delhi Gas Pipeline Corporation*, Docket No. CP81-205, (16 FERC ¶ 61,062), the Commission authorized a 20-year transportation service by an intrastate gas pipeline company for an interstate gas pipeline company, pursuant to Section 284.127 of the Commission's regulations under the NGPA. The applicant was specifically authorized to transport gas from existing points of receipt in fifteen Texas counties and redeliver the gas to United Gas Pipe Line Company at nine existing points of delivery, also in Texas. In addition to authorizing transportation between the named established points, the Commission authorized transportation of additional gas supplies that might be acquired by United within the counties in which the existing points of delivery were located. Although Section 284.127 requires an applicant to list the points of receipt and delivery in his application, the Commission granted Delhi the additional authority to include such future points of receipt in the named counties and points of delivery to United as might be needed to transport any additional gas reserves acquired by United in the future, obviating the necessity of amending the authorization.

3. Market Expansion

Failure of the Commission to afford an evidentiary hearing on adequacy of gas supply prior to certificating a gas pipeline company to increase the peak-day entitlements of some of its distributor customers resulted, on appeal, in remand for an opportunity for the Commission to explain adequately its reasons for denying the hearing. *General Motors Corporation* v. *Federal Energy Regulatory Commission*, 656 F. 2d 791 (D.C. Cir. 1981). In 1979, Michigan Wisconsin Pipe Line Company (Michigan Wisconsin) filed an application to increase peak-day entitlements for twenty of its distribution customers and to construct the additional facilities necessary to accommodate the expected increased deliveries. General Motors, which purchases gas from several distribution customers of Michigan Wisconsin for which no increases in peak-day entitlements were sought, moved to intervene and requested the Commission, under the Natural Gas Act, to hold a formal evidentiary hearing on the issue of whether Michigan Wisconsin's long-term and short-term gas supplies were adequate to support the increased service. While allowing General Motors' intervention, the Commission denied the request for a hearing, citing two reasons: (1) the pipeline company's request was for a change in only peak-day entitlements and not in annual entitlements, and (2) Michigan Wisconsin had not recently curtailed any customers and did not anticipate curtailments in the near future. The court, noting that the company's earlier showings of supply adequacy were all at least several years old, said the Commission seemed "to assume that the validity of the previous adequacy-of-supply showings continues uneroded by the passage of time." (656 F. 2d at 796). On the not-in-curtailment point, the court said: "Surely the Commission could not have meant to suggest that, since Michigan Wisconsin's supply situation is adequate in the short-term, it must necessarily be adequate in the long-term." (*Id.* at 797). The case was remanded to the Commission for reconsideration of its decision not to conduct an evidentiary hearing on the issue of the company's long-term supply.

4. Enforcement

The Commission, in its Report on Investigation and Order, issued December 30, 1981 in *Texas Sea Rim Pipeline, Inc.*, Docket No. IN80-10, (17 FERC ¶ 61,302), found that a gas pipeline company and its parent producing company had violated Section 7(c) of the Natural Gas Act and Sections 157.5(a), 157.6(b)(4) and 157.20(c) of the regulations by constructing jurisdictional pipeline facilities without having obtained prior certificate authorization and by failing to disclose that the construction was taking place while a certificate application was pending. The Commission also criticized the companies' outside and in-house counsel for having inadequately advised the firms as the pipeline project developed. The two companies were ordered to cease and desist from commencing the construction of jurisdictional facilities without a certificate and to report how they would seek to ensure "full regulatory compliance in the future." No sanctions were imposed on the attorneys, although the order is instructive for the admonition to the legal profession it contains. The Commission said:

> As the natural gas industry becomes less regulated, the role of the private sector attorney in assuring regulatory compliance is emphasized. Consistent with the Commission's desire to improve the regulatory environment is its concern that attorneys exercise that degree of care which a reasonably prudent attorney would exercise in the same or similar circumstances given a similar level of experience and the same or similar type practice designed to ensure that their clients adhere to the requirements of relevant statutes and regulations and make full, careful disclosure in their dealings with the Commission. The attorneys involved in this matter did not exercise that degree of care.

II. The Alaskan Natural Gas Transportation System

The year 1981 saw the initiation of construction for the prebuilt eastern and western legs of the Alaskan Natural Gas Transportation System (ANGTS), while regulatory procedures and analysis continued on the application to construct and operate the Alaska segment of the system. The most significant event of 1981 for the ANGTS was Congressional approval of certain waivers of law to facilitate the construction and operation of the ANGTS.

A. *Lower Forty-Eight Prebuilt Facilities and Related Imports*

Work commenced on the actual construction of the prebuilt eastern and western legs of the ANGTS system. By the end of the year Pacific Gas Transmission Company had completed the prebuilt portion of the western leg authorized in 1980 and started actual operation of such facilities with the transportation of imported Canadian gas. Construction of the prebuilt Northern Border Pipeline (Northern Border) began in 1981 and is scheduled for completion in 1982. Commencement of Northern Border construction in the state of North Dakota was delayed until the favorable resolution of certain litigation involving the route of its pipeline in such state. On April 30, 1981, the United States District Court for the District of North Dakota, Southwestern Division, in Case Nos. AL-80-139, *FERC et al. v. The Public Service Commission of the State of North Dakota, et al.* found that certain North Dakota statutes, which the state Public Service Commission had relied on to require Northern Border to construct its pipeline facilities in North Dakota in a different pipeline corridor than that previously selected by the President and approved by the Commission, conflicted with the Federal scheme for the routing and construction of the pipeline to be built pursuant to the Alaska Natural Gas Transportation Act, 15 U.S.C. 717 *et seq.* and therefore to that extent must yield to overriding Federal law.

On April 24, 1981, the Commission granted Northern Border a certificate of public convenience and necessity to construct and operate an additional compression station as part of its prebuilt facilities and to receive and transport up to 175,000 Mcf of natural gas per day to be imported from Canada by Northern Natural Gas Company and Natural Gas Pipeline Company of America. (15 FERC ¶ 61,073).

On July 10, 1981, the Commission, pursuant to Executive Order Nos. 10485 and 12038 and the Secretary of Energy's Delegation Order No. 0204-8, granted Northern Border a permit authorizing Northern Border to construct, operate, maintain and connect natural gas transmission facilities at the international boundary near Port of Morgan, Montana.

B. *Alaska Segment*

In 1981 various technical conferences were held on the Alaskan Northwest Natural Gas Transportation Company's (Alaskan Northwest) application in Docket No. CP80-435 for a certificate of public convenience and necessity to construct and operate the Alaska segment of ANGTS. As a result of these conferences a report for public comment was issued on August 21, 1981 by the Alaskan Delegate and the Director, Audit and Cost Analysis, Office of the Federal Inspector, on a proposed Certification Cost and Schedule Estimate and a proposed Center Point for the Incentive Rate of Return for the Alaskan segment. On November 23, 1981, Alaskan Northwest filed an amendment to its application providing additional data to the Commission relevant to establishing the certification cost and schedule estimate for the Alaska segment. As a result of this amendment, the Commission reconvened technical conferences to consider the new data.

Also during 1981, Congress approved, by joint resolution, certain waivers of law, communicated by the President to Congress on October 14, 1981, in accordance with Section 8(g) of the Alaskan Natural Gas Transportation Act of 1976, to facilitate the construction and operation of the ANGTS. As a result of these waivers (1) producers of Alaskan natural gas may be permitted to participate in the ownership of the Alaskan pipeline segment, provided it would not be inconsistent with antitrust laws and not create restrictions on access to the Alaskan segment for non-owners or restrictions on expansion; (2) the Prudhoe Bay gas conditioning plant is to be considered part of the ANGTS; (3) the Commission may allow certain billing to commence and collection of rates to begin once certain segments of the system (conditioning plant, Alaska and Canada) are completed and ready for service even though other segments of the system may not be ready for service, but not before an expected in-service date to be established for the ANGTS by the Commission, (4) the Commission may, at its discretion, decide whether formal evidentiary hearings are necessary for applications seeking authorization to construct and operate any segment of the ANGTS; (5) the Commission cannot change the provisions of any final rule or order approving any ANGTS-related tariff that would impair the recovery of actual construction and operation expenses, actual current taxes and amounts for debt service for the approved transportation system and the recovery by the purchasers of Alaskan gas of all costs related to the transportation of such gas pursuant to an approved tariff; (6) Alaskan Northwest or its successor is deemed to be a "natural-gas company" at such time as it accepts a final certificate to construct and operate the Alaskan segment of the ANGTS; and (7) the need for the shippers to apply under Section 3 of the Natural Gas Act for authorization to export Alaskan gas into Canada and reimport the gas back into the United States is eliminated.

C. *General ANGTS Conditions*

On February 23, 1981 the Commission issued an order requiring the ANGTS project sponsors to comply with the executive agreement between the United States and Canada, embodied in an exchange of notes, signed June 10, 1980, with respect to reciprocal procurement procedures for the United States and Canadian segments of the system. (14 FERC ¶ 61,159).

D. *Audit of Partnership Expenditures*

On May 1, 1981, the Commission issued an Order to Show Cause in Docket

No. CP78-124 (15 FERC ¶ 61,116) why it should not approve two reports from the Office of the Chief Accountant respecting expenditures of the Northern Border Pipeline Company for inclusion in its rate base. Responses to this order have been filed; however, no Commission decision on this matter was issued in 1981.

E. *Office of the Federal Inspector*

On March 8, 1981 the Office of the Federal Inspector for the ANGTS (Federal Inspector) announced a Notice of Tentative Decision and Request for Public Comments on the final design cost estimate for the prebuilt Northern Border pipeline. In its Tentative Decision, the Federal Inspector proposes to set Northern Border's Final Design Cost Estimate, which is used to determine the Incentive Rate of Return, at $180 million dollars above the Commission's certificate cost and schedule estimate of $1,061,581,000 (1979 dollars) as a result of changes to Northern Border's certificated design.

The Federal Inspector, in October of 1981, in its Order No. 3, issued a statement of policy on general standards and procedures by which it will audit and approve, for inclusion in rate base, the construction costs of the three United States segments of the ANGTS. Comments from the public were requested on this statement of policy.

III. Storage Certificate Activities

In *Frontier Gas Storage Company, et al.*, Docket Nos. CP80-570 *et al.* (March 12, 1981), (14 FERC ¶ 61,228), the Commission authorized a project designed to facilitate the financing of storage inventories by Montana-Dakota Utilities Co. (Montana-Dakota). Montana-Dakota sells the gas that it injects into storage for its own acount to Frontier. Frontier holds title to the gas until it is needed to serve Montana-Dakota's customers. Montana-Dakota sells to Frontier at a rate stated in its FERC Gas Tariff (which in essence tracks the system's average cost of gas), and Frontier sells back to Montana-Dakota under a cost of service tariff which provides that Montana-Dakota will reimburse Frontier for all of its costs, but that Frontier will earn any profit as such. This arrangement allows Frontier to finance the cost of the storage gas entirely by means of debt, which, the Commission found, enables Montana-Dakota "[t]o obtain capital at no greater cost than any other method of obtaining capital and at a possible savings to the ratepayer."

IV. Rate Conditions Imposed in Certificate Proceedings

Major projects in which the Commission also considered rates are discussed in Chapter I(A), *supra*.

In determining the sales price of natural gas in an off-system sale in *Northern Natural Gas Company*, Docket No. CP81-236-000 (July 31, 1981) (16 FERC ¶ 61,109), the Commission rejected a proposal espoused by Northern Natural Gas Company (Northern) that El Paso Natural Gas Company (El Paso) be charged the maximum lawful price under Section 102 of the NGPA at the time of delivery. The Commission observed that adopting this proposal could reduce or eliminate any benefit to Northern's customers, since its average purchased gas cost would undoubtedly increase more rapidly than the Section 102 price. To alleviate this situation, the Commission certificated the transaction upon the condition that the rate be equal to Northern's interruptible pipeline overrun service, which provides a rate equal to the unit charge at a 100 percent load factor of the contract demand service. The 100 percent load factor requirement would assure that Northern's customers would benefit from the sale despite increased purchased gas costs, and that Northern would be able to recover its increased costs under its sales refund obligation (SRO).

The Commission further required Northern to credit to Account No. 191 the difference between the rate charged to El Paso, the off-system purchaser, and the unit fixed cost component of its SRO. This was done for the reason that the fixed cost component of the rate to El Paso would exceed the fixed cost component of the SRO. The Commission specifically found authority for such crediting of revenues in Section 7(e) of the Natural Gas Act, distinguishing *Panhandle Eastern Pipe Line Company v. FERC*, 613 F. 2d 1120 (D.C. Cir. 1979), *cert. denied*, 101 S. Ct. 247 (1980), as follows:

> In *Panhandle*, the Commission attached a rate condition requiring revenue crediting to offset purchased gas costs to a certificate authorizing a transportation service that did not involve additional purchase gas costs to Panhandle's ratepayers. The certificate condition required the crediting of the transportation revenues in order to avoid the double recovery of costs by the pipeline. The result of the crediting was to adjust a previously authorized rate paid by customers who had no relation to the service being certificated. In contrast, in an off-system sale of surplus gas, the selling pipeline's ratepayers will pay increased purchased gas costs as a consequence of the sale. The revenue-crediting requirement would have the effect of minimizing the extent of such purchase gas cost increases. Therefore, the crediting of these contemporaneous sale revenues to the PGA Account No. 191 to offset increased purchased gas costs due to the sale authorized here does not raise the concerns expressed by the *Panhandle* court.

The Commission has had the opportunity to examine the appropriate rate charged or revenue treatment in a number of other off-system sales. They have consistently ordered that the sales be made at a 100 percent load factor rate. As explained in *Northern Natural Gas Company, Division of InterNorth, Inc.*, Docket No. CP81-349-000 (December 11, 1981) (17 FERC ¶ 61,228), use of such a rate takes into account increases in the cost of purchased gas and assures that jurisdictional customers are not improperly subsidizing the sale. See also *Cities Service Gas Company*, Docket No. CP80-499-004 (December 3, 1981) (17 FERC ¶ 61,200), requiring that an existing sale price be changed so as to reflect increases in the weighted average cost of gas. The Commission has also repeatedly ordered that excess revenues be credited to Account No. 191, *Colorado Interstate Gas Company*, Docket No. CP81-174 (August 11, 1981) (16 FERC ¶ 61,125). Similar conditions have been imposed where the sale is made to a local distribution company rather than another interstate pipeline. *Natural Gas Pipeline Company of America*, Docket No. CP81-392-000 (November 13, 1981) (17 FERC ¶ 61,133).

Finally, on September 10, 1981 in *NGPL-Canyon Compression Co.*, Docket No. CP80-547 (16 FERC ¶ 61,175), the Commission issued a conditional certificate to permit the construction of a concrete foundation, walls and floors of a compressor building as well as concrete required for other appurtenant facilities. The project proposed by NGPL-Canyon Compression Co. (NGPL-Canyon) was dependent upon approval of the Trailblazer System, which was then pending before the Commission. In issuing the certificate and approving construction, the Commission noted that the construction would be at NGPL-Canyon's sole risk, and that should a permanent certificate to complete the project not be issued, jurisdictional customers could not be required to pay for the preliminary construction.

V. Regulation of Independent Producers Under Section 7 of The Natural Gas Act

A. *Scope of the Commission's Authority Under Section 7(c)*

The Commission's orders precluding holders of optional procedure certificates under 18 C.F.R. Section 2.75 from collecting NGPA prices for gas not removed from jurisdiction under the Natural Gas Act were affirmed in *Columbia Gas Development Corp.* v. *FERC*, 651 F.2d 1146 (5th Cir. 1981). The Commission determined that the holder of an optional procedure certificate is precluded under the terms of the certificate from filing under Section 4(d) of the Natural Gas Act to collect either the NGPA Section 104 or 102(d) price. Various producers asserted that the waiver provision in Section 2.75 (m)(1) of the regulations applied only to increases in rates established by the Commission under the Natural Gas Act and that, in any event, the NGPA effected a repeal of either the optional procedure certificate waiver or the filing requirement under Section 4 of the Natural Gas Act. The Court rejected the arguments of the producers and held that the waiver condition precluded optional procedure certificate holders from filing for ceiling prices under the NGPA to the extent the gas so certificated remains subject to the Commission's jurisdiction under the Natural Gas Act. The Court found that the appropriate procedure for relief from the optional procedure certificate waiver condition is a petition for special relief.

In *Air Products & Chemicals, Inc.* v. *FERC*, 650 F.2d 687 (5th Cir. 1981), the Court vacated and remanded FERC Opinion Nos. 10 and 10-A, which had rescinded certain temporary and permanent certificates issued previously for the transportation and/or exchange of federal offshore gas reserved by various producers for their own use, for use by affiliated companies, or for direct sale to specified customers. The Commission had terminated the certificates based on its determination that the policy of *In re Chandeleur Pipe Line Co.*, 42 FPC 20 (1969), permitting producer reservation of offshore federal domain gas, was no longer necesary to encourage the further development of offshore reserves and could no longer be justified in the face of serious worsening curtailments in the interstate market. The Court held that the Commission had relied on evidence outside the record to support its finding that the interstate market faced deepening curtailments, thereby denying producer parties an opportunity for rebuttal and precluding effective judicial review. The Commission was directed on remand (i) to specify the data on which it had relied in finding an increasing curtailment problem and (ii) to reopen the hearings to allow the producers an opportunity to present evidence and make comments. The Commission was also directed to address the request of consumer parties to require paybacks of gas or monetary refunds by the producer to the interstate market for gas transported under the rescinded certificates.

In *Tennessee Exploration* v. *FERC*, 649 F.2d 376 (5th Cir. 1981), the Fifth Circuit reversed a Commission order imposing a certificate condition which limited the price for certain gas from the Outer Continental Shelf to no more than the applicable maximum lawful price under Section 104 of the NGPA. The Commission had found that the Section 104 prices were applicable because, as of November 8, 1978, there were natural gas rate orders in existence that would apply to the gas if it had been sold in interstate commerce. Tenneco maintained that Section 104 prices were inapplicable because the absence of actual deliveries of gas prior to November 8, 1978, meant that the gas was neither "dedicated" nor subject to a ceiling price under the Natural Gas Act on that date. The Court set aside the certificate pricing condition, finding that the gas was covered under Section 109(a)(2) of the NGPA because it was not dedicated to interstate commerce within the meaning of the Natural Gas Act on November 8, 1978 and was therefore not subject to a ceiling price under the Natural Gas Act on that date.

B. *Service Obligations and Abandonments*

In *Mitchell Energy Corp.* v. *FERC*, 651 F.2d 414 (Cir. 1981), the Court reversed the Commission's determination that gas produced from wells subject to a contractual release provision remained dedicated to interstate commerce until and unless an abandonment authorization under Section 7(b) of the Natural Gas Act was obtained. The gas sales contract provided for the release of acreage surrounding wells which the purchaser refused to connect. The Commission found that gas produced from seventeen such wells remained dedicated to interstate commerce and ordered Mitchell to file abandonment applications. The Court found the Commission's order to be based on the conclusion that neither the issuance of the certificate nor the acceptance of the contract for filing as a rate schedule constituted approval by the Commission of the contractual release provision. According to the Court, such a conclusion as to the service obligation imposed by the certificate was inadequate in that it was not supported by any analysis or interpretation of the contract itself. The Court did not decide whether the gas in question was, in fact, dedicated to interstate commerce, but remanded the case to the Commission for further consideration and explanation.

By order dated March 27, 1981, in *Cities Service Oil Co.*, Docket No. G-4579, the Commission granted an application for partial abandonment of service and ordered refunds as to certain past sales of gas. Cities had filed an abandonment application on March 19, 1973, as to sales to Colorado Interstate Gas Company, but the Commission never granted the request for abandonment authorization. Beginning in July, 1973, Cities commenced emergency sales and later, limited term sales, to Panhandle Eastern Pipe Line Company from the same acreage at rates in excess of those to which it was entitled under the certificate covering sales to Colorado Interstate. Finding that an unauthorized abandonment had occurred, the Commission nonetheless granted Cities' 1973 abandonment application because "sales were made to another interstate pipeline company and apparently comparatively small volumes of gas were involved in such sales." In view of these facts, and the requirement that Cities must refund with interest all amounts collected in excess of the applicable just and reasonable ceiling rate, the Commission determined to take no further action with respect to the unauthorized abandonment.

VI. Special Certificate Issues

On January 21, 1981, the Commission, in an effort to eliminate the reporting of unnecessary data, issued Order No. 121 revising the Form 2 Annual Report for Class A and B natural gas pipelines (FERC Statutes and Regulations, ¶ 30,222). The Commission adopted all of the revisions suggested on July 1, 1980 in the Notice of Proposed Rulemaking to Revise Form No. 2 (FERC Statutes and Regulations, ¶ 32,072). These revisions included elimination of 33 schedules, revision of the reporting instructions on 17 schedules, establishment or revision of threshold reporting levels on 13 schedules, and elimination of the requirement of Certified Public Accountant certification on 15 of the 19 schedules which had required certification. Certification is now required only for the four basic financial statements: Balance Sheet, Income Statement, Statement of Retained Earnings and Statement of Change in Financial Position.

The Commission also extended the filing deadline for Form 2 from March 31 to April 30. The revisions are expected to reduce the reporting burden by 19 percent.

In *McCulloch Interstate Gas Corporation* v. *FERC*, 642 F.2d 456 (9th Cir. 1981), the Court concluded that the Commission Staff erroneously rejected a tariff filing submitted by McCulloch Interstate Gas Corporation (McCulloch) in 1978 to cover continuation of gas transportation service rendered to Colorado Interstate Gas Company (Colorado Interstate).

In 1973, McCulloch entered into a five year agreement to transport gas received in the Spearhead Ranch area of Wyoming from Mountain Fuel Supply Company for delivery to Colorado Interstate. The transportation was authorized under a temporary certificate in June 1974 and a permanent certificate in February 1976.

Under a 1976 contract, McCulloch agreed to sell 71 miles of gas transmission lines to Colorado Interstate, including the lines used to provide the transportation service. The contract contained a clause giving Colorado Interstate the right to connect new gas supplies acquired by it along the pipeline until the Commission approved the sale of the facilities and termination of the transportation agreement. In return, McCulloch could purchase up to 25 percent of the new gas at each such delivery point.

McCulloch submitted the 1976 contract as an additional tariff sheet, explaining in an accompanying letter that expiration of the 1973 transportation contract would leave the 1976 contract as the only contract for the continuation of the transportation service. It claimed the 1976 contract provided for transportation service in the interim period until Commission approval of the sale could be obtained. The Director of the Office of Pipeline and Producer Regulation summarily rejected the filing on the grounds that it encompassed uncertificated service. According to the Commission Staff, the filing failed to comply with 18 C.F.R. Section 154.22 which states that no company may file a rate schedule until after a certificate of public convenience and necessity has been granted for the service. The Staff claimed that the filing applied to new uncertificated sales of natural gas.

McCulloch appealed to the Ninth Circuit. The Court remanded the case to the Commission, concluding that McCulloch's tariff substantially complied with the Commission's regulations and was erroneously rejected. The Court found that the Commission Staff has misconstrued the "new" language of the 1976 contract to include noncertificated services. A proper reading of the 1976 contract and the letter accompanying the tariff showed that McCulloch was simply seeking approval to continue existing service. The 1976 contract expressly noted that further Commission approval was necessary before it could be implemented; therefore, the tariff filing did not encompass uncertificated service.

On March 6, 1981, the United States Court of Appeals for the D.C. Circuit affirmed Commission Order No. 30 which authorized the fuel oil displacement program. *The Process Gas Consumers Group* v. *FERC*, 652 F.2d 196 (D.C. Cir. 1981). At the request of the Economic Regulatory Administration (ERA), the Commission authorized the program as an attempt to lessen a serious fuel oil shortage in the spring of 1979 by making natural gas more accessible to fuel oil users. Order No. 30, issued May 17, 1979, authorizes interstate pipelines to transport gas for ERA-certified "eligible users" without obtaining a Section 7 certificate so long as the producer sales price does not exceed the NGPA first sale ceilings of Section 311(b). The program was originally slated to terminate June 1, 1980, but was later extended until May 31, 1981.

The Process Gas Consumers Group challenged the order, claiming that the Commission had not adequately considered the impact of Order No. 30 on natural gas consumers, particularly high priority users. In a one page memorandum opinion, the D.C. Circuit found that the challenged orders were based on valid policy considerations and the adoption of the program after formal rulemaking proceedings was not arbitrary or capricious.

On May 21, 1981, the Commission issued Order No. 30-F which extended the program until 90 days after the effective date of a final rule in Docket No. RM81-19, a pending proceeding to revise pipeline certificate procedures. In Docket No. RM81-19, initiated March 10, 1981, (FERC Statutes and Regulations, ¶ 32,117), the Commission proposed a major streamlining of pipeline certificate procedures, including the use of blanket certificates for routine pipeline actions or for those with limited financial impact. Docket No. RM81-19 included a proposal for the use of blanket certificates to authorize natural gas transportation for up to five years for fuel oil displacement purposes.

On July 26, 1981, the Commission affirmed an initial decision approving applications by the High Island Offshore System (HIOS) and U-T Offshore System (UTOS) to expand the capacity of existing pipeline facilities in the Gulf of Mexico, but modified the allocation of the additional capacity among shippers. *High Island Offshore System*, Docket No. CP75-104 (16 FERC ¶ 61,074). HIOS proposed to amend its certificates to increase its certified firm capacity from 988,000 Mcf per day to 1,362,400 Mcf per day and to render interruptible overrun service to the extent of available capacity. The increased capacity would result from uprating a compressor and installing liquid handling facilities. UTOS proposed to increase its certified firm capacity from 730,000 Mcf per day to

1,200,000 Mcf per day and to render interruptible overrun service through construction of additional facilities.

Four intervenors challenged the necessity of the expanded capacity, claiming that expansion would lead to an overly rapid depletion of reserves and allow gas to be made available for current low priority uses to the detriment of future high priority uses. The Administrative Law Judge approved the expansions noting that the Commission had rejected similar arguments against expansion of pipeline capacity in other proceedings.

The Law Judge found that allocation of HIOS' existing capacity on the basis of ownership shares of affiliated shippers and original transportation requests of nonaffiliated shippers was not unlawfully discriminatory because there was a rational basis for treating the two types of shippers differently: the affiliated shippers undertook ownership risks not undertaken by the nonaffiliated shippers. The Law Judge found that allocation of the additional capacity created by the expansions on the basis of updated shipper transportation requests at the time of the application was justified.

The Commission affirmed all of the Law Judge's conclusions, except for that related to the allocation of the additional capacity. The Commission concluded that a better allocation of the additional capacity would result from an allocation based on contract demands the shippers requested in a later proceeding, Docket No. CP80-408 (Phase II). In Docket No. CP80-408, HIOS proposed further expansion of the pipeline system. The Commission found that the capacity requested by each shipper in Phase II of Docket No. CP80-408 better represented the long term needs of the shippers. An allocation based completely on Docket No. CP80-408, however, would result in some shippers receiving a smaller allocation than their current allocation. Therefore, the Commission concluded that those shippers whose allocation under Docket No. CP80-408 would be smaller than their current allocation will be allocated their current allocation. The remaining firm capacity will be allocated pro rata among the other shippers based on the contract demands in Phase II of Docket No. CP80-408.

This report is respectfully submitted by the Chairman, Vice Chairman, and members of the committee on Natural Gas Certificate and Authorization Regulations.

Joel F. Zipp, Chairman
Sheila Jackson Lee, Vice Chairman

W. Johnathan Airey
Allan W. Andersen, Jr.
Christopher T. Boland
Linda E. Buck
Paul W. Diehl
Joseph S. Englert, Jr.
Bernard A. Foster, III
Robert J. Haggerty
Alfred O. Holl
Craig W. Hulvey
Glenn W. Letham
Robert A. Jablon
Phil W. Jordan
J. Curtis Moffatt
Demetrios G. Pulas, Jr.
Henry C. Rosenthal, Jr.
Frank P. Saponaro
Stephen K. Schroeder
William C. Spence