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THE ROLE OF INTERNAL AND EXTERNAL FACTORS IN THE IMPLEMENTATION OF DISRUPTIVE COURT ORDERS BY THE FEDERAL ENERGY REGULATORY COMMISSION

DISSERTATION

Presented in Partial Fulfillment of the Requirements for the Degree Doctor of Philosophy in the Graduate School of The Ohio State University

By

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*****

The Ohio State University 1999

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ABSTRACT

A court, ordering an administrative agency to discontinue a policy or to do something differently, begins a sequence of events that may involve not only the agency but also others in its environment and that results in some type of response to the order. Two main questions are considered in this research. The first is how does the agency actually respond to this disturbance: what does it do and why? The second is what role, if any, do influential outsiders including members of Congress, representatives of interest groups and other officials from the executive branch have in shaping the agency response to the court order?

This study concentrates on the Federal Energy Regulatory Commission (FERC) and its natural gas regulations. The FERC oversees the interstate flow of both electricity and natural gas with gas regulation being a particularly volatile area of public policy. As a result, the Commission is a constant target of litigation in the federal appellate courts. Five such instances, decided by the District of Columbia and Fifth Circuits during the Reagan administration (1981-89), are examined in separate case studies.
Five independent variables, agency commitment to its existing program, the disruptiveness of the court order, the likelihood and severity of penalties for noncompliance with the court order, agency views of the court, and external pressures on the agency, are analyzed with respect to their relative influence on the dependent variable of agency response to the court. The analysis is qualitative, marshalling facts and evidence gathered from several major data sources: FERC orders, policy statements and newsletters, trade press accounts, congressional hearings, and personal and telephone interviews conducted by the author with FERC staff and commissioners, interest group representatives, and congressional staff.

The research shows that the FERC generally implemented the court orders although some evasion was found in four of the five cases. The evasiveness can be explained at least partly by the fact that the FERC was highly committed to its programs. Agency view of the court as a legitimate authority to be obeyed turned out to be a much stronger force than originally expected and was a major counter to any tendencies to evade the judicial mandates. External pressure was important only in those cases with widespread impact on the industry while disruptiveness became significant when redefined as disruption for the gas industry rather than for the FERC. A surprising finding was that likelihood of penalties for noncompliance was relatively insignificant in all five cases.
Dedicated to Mom, Dad, and God
ACKNOWLEDGMENTS

This work has been years in preparation and there are various folks that I must acknowledge. At the same time, I also grant those listed below absolution from any continuing limitations or flaws of this research the responsibility for which remains mine alone. First and foremost, I would like to thank the members of my dissertation committee who are three genuine stars of the political science department. Professor Lawrence Baum, my adviser, is a consummate professional and serious scholar. He has helped me at every step of this process beginning quite a few years ago when I was stumbling around trying to define a topic and research questions. He has pushed and prodded, always seeking to make me a more serious analyst in spite of myself. This work is much better as a result of his efforts.

Professor (now Dean) Randall Ripley provided some very important suggestions on elite interviewing, a subject with which he has had substantial experience. The interviews, an important data source for this research, were much more productive as a result. His wit and willingness to serve on my committee are much appreciated. Professor
Aage Clausen's methodological expertise and suggestions on question wording were very valuable resources and resulted in a better research product. His recommendations on summarizing and editing the rather large amount of information in these chapters made this a more readable tome. His (as well as Professors Baum and Ripley's) willingness to work their way through what must have seemed at times a particularly dry piece are greatly to be praised.

I would also like to thank the three dozen or so people who agreed to be interviewed either in person or over the phone for this research. All were quite busy but all took the time, even if for just a few moments. Their insights and experiences provided a wealth of information that could not have been obtained easily otherwise. Their input was crucial to this effort and I am very grateful.

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Finally, this dissertation is dedicated to three individuals. Two of them wondered if I would ever finish and get on with life. The third, I believe, knew all along but never told me.
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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstract</td>
<td>ii</td>
</tr>
<tr>
<td>Dedication</td>
<td>iv</td>
</tr>
<tr>
<td>Acknowledgments</td>
<td>v</td>
</tr>
<tr>
<td>Vita</td>
<td>viii</td>
</tr>
<tr>
<td>List of Tables</td>
<td>xi</td>
</tr>
<tr>
<td>List of Figures</td>
<td>xii</td>
</tr>
<tr>
<td>Chapters:</td>
<td></td>
</tr>
<tr>
<td>1. Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Literature Review</td>
<td>3</td>
</tr>
<tr>
<td>Research Design</td>
<td>49</td>
</tr>
<tr>
<td>The Organization of the Study</td>
<td>65</td>
</tr>
<tr>
<td>2. Overview of Federal Natural Gas Regulation</td>
<td>67</td>
</tr>
<tr>
<td>The Natural Gas Act</td>
<td>67</td>
</tr>
<tr>
<td>The Natural Gas Policy Act of 1978</td>
<td>72</td>
</tr>
<tr>
<td>The Federal Energy Regulatory Commission</td>
<td>75</td>
</tr>
<tr>
<td>The Regulatory Environment</td>
<td>87</td>
</tr>
<tr>
<td>Conclusion</td>
<td>143</td>
</tr>
<tr>
<td>3. The Court Cases</td>
<td>146</td>
</tr>
<tr>
<td>The Mid-Louisiana Case</td>
<td>149</td>
</tr>
<tr>
<td>The INGAA &quot;Wet&quot; vs. &quot;Dry&quot; Rule Case</td>
<td>169</td>
</tr>
<tr>
<td>The Maryland People’s Counsel Cases</td>
<td>186</td>
</tr>
</tbody>
</table>
# LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Indicators and data sources for the independent and the dependent variables</td>
</tr>
<tr>
<td>2.1</td>
<td>Major gas producing and gas consuming states, 1987</td>
</tr>
<tr>
<td>2.2</td>
<td>Membership of the House and Senate Appropriations Subcommittees on Energy, 100th Congress (1987-88)</td>
</tr>
<tr>
<td>2.3</td>
<td>Membership of House Subcommittee and Senate Committee on Energy, 100th Congress (1987-88)</td>
</tr>
<tr>
<td>2.4</td>
<td>Major natural gas industry related interest groups during the Reagan administration</td>
</tr>
<tr>
<td>2.5</td>
<td>Major governmental and interest group actors in the FERC natural gas policymaking environment during the Reagan term</td>
</tr>
<tr>
<td>3.1</td>
<td>FERC policy decisions, active interests, court decisions, and FERC responses in the five cases</td>
</tr>
<tr>
<td>4.1</td>
<td>Relationship between the independent variables and the dependent variable in the five cases</td>
</tr>
<tr>
<td>4.2</td>
<td>Positive/negative effects of the independent variables on the dependent variable in the cases</td>
</tr>
<tr>
<td>A.1</td>
<td>Natural gas and FERC-related acronyms and abbreviations used in the study</td>
</tr>
</tbody>
</table>
LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Steps in the FERC &quot;notice-and-comment&quot; rulemaking process including judicial review</td>
<td>80</td>
</tr>
<tr>
<td>2.2</td>
<td>FERC hearing/adjudicatory process leading to judicial review</td>
<td>85</td>
</tr>
</tbody>
</table>
CHAPTER 1

INTRODUCTION

A court, ordering an agency to discontinue a policy or to do something differently, begins a sequence of events that may involve not only the agency but also others in its environment and that results in some sort of response or reaction to its order. Two main questions are considered in this research. These concern the process of the agency's response to the court and the role of outsiders in that process. The first is how does an administrative agency, directed by a court to discontinue a policy or to do things differently, actually respond to this disturbance? What does it do and why? This is a basic concern in implementation studies (i.e., how is a new or alternative policy implemented by a bureaucracy?) and it is the main focus here.

The second question is what role, if any, do influential outsiders, including members of Congress, representatives of interest groups, and other officials from the executive branch, have in shaping the agency's response to the court order? This query probes the issue of the relative influence of internal vs. external factors in agency decision making, both in times of routine policymaking and in times of disruption.

The contribution of this particular research effort is the broader perspective that it takes on the implementation process. Scholars proposing models of implementation have noted the importance of environmental factors in implementor decision making. However, studies of the implementation of judicial decisions by administrative agencies have
concentrated traditionally on the implementing agency itself, excluding the outside forces in fashioning their explanations of whether the court orders have been faithfully implemented or evaded. More recent studies of judicial implementation have taken the broader approach.

The study concentrates on the Federal Energy Regulatory Commission (FERC) and its natural gas authority. The FERC is the regulatory body charged mainly with overseeing the interstate flow of electricity and natural gas. Natural gas regulation has been a particularly volatile area of public policy and the FERC a target of much litigation. How the Commission responds to these assaults on its policies should prove instructive.

Five court orders striking down programs or assertions of authority by the Commission are examined in separate case studies. The intent is to study the variations in response by the Commission to these orders and to assess the influence of five independent variables, described in a later section of this chapter, on the dependent variable of response in each case and across cases.

The discussion in this chapter takes the following form. The next section contains a literature review that includes a discussion of implementation studies. Part of this review covers the major factors identified by scholars as influencing the implementation of policy in general and the implementation of disruptive court orders in particular. The role of various outsiders in agency operations and some authors’ observations on court-agency interaction are also covered. A description of the five independent variables suggested by the literature as being of major importance in explaining agency response to the court follows. The final section of this chapter contains a description of the organization of the study.
Literature Review

This literature review is intended to serve as a basis for the subsequent discussion of the variables used in this study. It is patterned after the two guiding questions of the research: implementing a new or different policy and external influence on bureaucracy. Studies of the implementation process are described in the first subsection below. Topics covered in the subsequent sections include subsystems and subgovernments, legislative oversight/dominance of the bureaucracy, principal-agent framework, and court-agency interaction.

Implementation

Scholars studying implementation have undertaken to identify important factors affecting its outcomes. They have also attempted to characterize the process itself, using such terms as "evolution," or "environment." The literature on important factors is covered first.

Major Factors in Implementation

Major variables in the implementation of policy identified in the literature include the dispositions of the implementors of the policy, the commitment of agency officials to the program, conflict and consensus within the agency over the goals of the policy, the amount of organizational change required by a policy, bureau ideology, and inducements and constraints. A variable of particular concern in the implementation of disruptive court orders is the agency officials' perceptions of penalties or sanctions for noncompliance with the court order.

Successful achievement of the goals of a policy will depend in large part upon the enthusiasm and determination of those officials charged
with administering the program. Donald Van Meter and Carl Van Horn
discuss the importance of the dispositions of the implementors of a policy
in their model of the policy implementation process. Important aspects
include the direction (acceptance, neutrality, or rejection) of officials' views on the standards and objectives of the policy and the intensity of
their positive or negative response to the policy.

A similar point is made by Paul Sabatier and Daniel Mazmanian
who note the importance of implementor commitment to the program in
their model of the implementation process. They state that:

No matter how well a statute structures the formal decision
process, the attainment of statutory objectives that seek to significantly modify target-group behavior is unlikely unless officials in the implementing agencies are strongly committed
to the achievement of those objectives.

According to Sabatier and Mazmanian, the commitment of officials to a policy will also be a function of the statute’s ability to "institutionalize a bias" in the implementing agency through the selection of institutions and top officials.

The next two factors, amount of change required by a policy and conflict and consensus within the agency over the goals of the policy

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2 Ibid., pp. 472-473.


4 Ibid., p. 20.
being implemented, are two important facets of the Van Meter-Van Horn model. The authors state that incremental change from previous policy and a low degree of required organizational change should ease a policy’s implementation. High goal consensus should also aid in the implementation of the policy. Of the two factors, change and goal consensus, Van Meter and Van Horn expect goal consensus to be more determinative of success in implementation.

Another factor of importance is the agency officials’ view of what the agency’s goals or mission should be. Anthony Downs discusses bureaucratic ideology, defining it as "a verbal image of that portion of the good society relevant to the functions of the particular bureau concerned, plus the chief means of constructing that portion." Top-level officials in an agency develop the bureaucratic ideology and may use it to foster goal consensus among current agency officials and to recruit new officials who will contribute to that consensus.

The multifaceted variable of inducements and constraints has been proposed by Malcolm Goggin and his colleagues in their model of state implementation of federal mandates. The category "content of the decision" consists of such factors as the type of policy, the ease with which the problem that is the target of the policy can be solved, and the certainty of policy effects. To increase the chances of successful implementation, the authors assert that the federal policymakers must provide sufficient resources as well as a credible solution to an important

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problem. The problem should be easier to solve or less controversial and the policy should not provide for massive redistribution of costs and benefits among different groups.

Another subset of federal inducements and constraints, more directly related to this research, is the legitimacy and credibility of the federal agency as perceived by the state agency. Implementation will be aided if the federal policymaker is perceived as authoritative (i.e. legitimate) in the policy area or on certain issues. Credibility involves the extent to which the federal policymaker can be trusted and includes the believability of threats of sanctions for noncompliance with the federal mandate.

The final factor affecting implementation (more specifically implementation of disruptive court orders) to be considered here is agency perceptions of penalties or sanctions for noncompliance with the court order. Charles Johnson has outlined the procedure that an agency, seeking to minimize the changes mandated by a disruptive court order, will undertake.\(^8\) He hypothesizes that if the commitment to the existing program is greater than any threat to its resources that the agency may

---

\(^8\) Charles A. Johnson, "Judicial Decisions and Organizational Change: A Theory," *Administration & Society* 11 (May 1979): 27-51. A distinction should be made at this point between compliance with and implementation of a court order. Johnson and Bradley Canon have provided definitions of these terms in their book on implementation of judicial decisions. They define "implementation" as actions by lower courts, government agencies, or other parties that are concerned with enforcing a court order. The definition of "compliance/noncompliance" or "evasion" is behavior that is consistent or inconsistent with the behavioral requirements of the court's decision. See Charles A. Johnson and Bradley C. Canon, *Judicial Policies: Implementation and Impact* (Washington, D.C.: CQ Press, 1984), pp. 14-15.
foresee from not complying, then compliance with the court order will be limited. If the threats are greater, however, then the agency will comply.9

Johnson hypothesizes also that the less severe the probable sanctions are for noncompliance, the more limited will be the changes that the agency will make in response to the court order. If the probable sanctions appear to be severe, then the agency will consider a wider range of alternative responses and make more extensive programmatic responses to the court.

Don Brown and Robert Stover also discuss the role of judicially imposed sanctions in gaining compliance with court orders.10 They hypothesize that compliance will vary with the proportion of the target population (those individuals and/or institutions whose behavior a court is trying to influence in its decision) that is composed of primary recipients (the participants in a case at whom the court order is directed). Secondary recipients (members of the target population not involved in the case but for whom the court has prescribed or prohibited certain types of behavior in its ruling) may or may not comply with the order. Their compliance will depend on the number of these secondary recipients and the number of parties willing to initiate litigation against them to insure compliance.11


11 Ibid., p. 470. If there is a small number of secondary recipients, they may feel that there is a greater chance of being sued and sanctions being imposed and they may thus comply. If there is a large number of parties willing to bring suit to insure compliance, the secondary recipients will feel a greater threat of judicial sanctions and thus comply.
Characterizations and Conceptualizations of the Process

As noted above, those studying implementation have made some observations about the entire process in addition to discussing important factors. The evolutionary nature of implementation has been noted by some authors while others (such as Nakamura and Smallwood and Johnson and Canon) have proposed frameworks for studying the process. Examples of these studies are described below.

Majone and Wildavsky have proposed an evolutionary perspective of implementation. In their view, policy is constantly changed by the process of implementation. Resources and objectives are altered as decisions are made about the goals to be carried out and the resources to be used. These authors assert that policy redesign rather than policy design is more frequent, stating that "we do not always decide what to do and succeed or fail at it; rather, we observe what we have done and try to make it consistent in retrospect."

Another author discussing policy change or evolution is Dvora Yanow who proposes a "policy culture" approach to the study of implementation. Part of this approach includes the culture of a specific policy issue, the values and beliefs that have shaped previous and current decisions and debates concerning that issue. These values influence implementers who are interpreting policy as they implement it. When an official interprets a policy, subsequent implementors no longer deal with

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13 Ibid., p. 172. Reference omitted.
the original policy but rather with the new interpretation. These interpretations are not random, however, as "they evolve within the culture of the policy issue."14

A major attempt to characterize the process of implementation is that of Nakamura and Smallwood.15 Implementation is one of the three "policy environments" that encompass the entire policy process and also include formation and evaluation. The various actors present in the implementation environment include policymakers who monitor and intervene in the implementation process. Other actors include the formal implementers, intermediaries (i.e. individuals and groups such as state and local officials and actors in the private sector who have been delegated responsibilities by the implementers to carry out policy objectives), interest groups, recipients or "consumers" of the policy outputs, the media, and policy evaluators. Each of these various actors will attempt to influence the course of implementation and the formal implementers must try to coordinate their actions to achieve policy objectives.16

Nakamura and Smallwood also discuss the organizational structures and bureaucratic norms that are important in the implementation environment. An important point made by the authors in discussing bureaucratic norms (or bureaucratic culture) is that the political environment of the implementing agency may not necessarily coincide with the goals espoused by policymakers. Implementers must thus try to balance the


16 Ibid., pp. 46-53.
internal norms of the agency against the external pressures exerted by other actors in the environment.\textsuperscript{17}

Robert Stoker has proposed a regime framework, defining "regime" as a "political arrangement that institutionalizes values important in public decision making" and also "a set of organizational arrangements that help to define and support the political values inherent in it."\textsuperscript{18} Implementation is dynamic as the costs and risks to its participants of defection from the regime increase over time while the costs and risks of cooperation decline. Implementation is also more difficult in the early stages as the regime is not fully developed. As time passes and the program constituency is established, implementation participants view continuation of the program as essential. In addition, the regime becomes more fully developed over time and thus cooperation and adaptation among the participants is more likely.\textsuperscript{19}

John Echeverri-Gent proposes the Organization Environment Perspective for analyzing agency-outsider relations and their impact on policy implementation. He defines agency autonomy as the ability of the bureaucracy to implement its own policies regardless of what other actors in its environment wish. Capture occurs when the agency is forced to pursue the objectives of those other actors without respect to its own

\textsuperscript{17} Ibid., pp. 58-59.


\textsuperscript{19} Ibid., pp. 38-39. Stoker also asserts, contrary to usual belief, that program reform should be easier as the policy ages. This would be so because the regime would have developed and participants would have little fear of exploitation by other participants. However, he also states that such reforms are more likely to succeed if they expand program benefits to new classes of beneficiaries and leave intact the benefits enjoyed by current participants. Ibid., pp. 39-40.
policy mandate. The author states that most agencies are between these extremes, being "embedded in social relations" with the other actors in the policy environment and having varied degrees of independence.20

The Organization Environment Perspective views agency-outsider relations in terms of a social network in which the actors exchange resources. The exchanges "constitute relations of power and dependence."21 Organizations must acquire resources from their environment in order to survive.22

Echeverri-Gent concludes that increasing the resources available to government agencies is not the only manner of achieving effective policy implementation. Persuading the various actors in the environment to use their resources to achieve policy objectives would be another important means to try especially when there is a widening gap between what is needed to realize policy goals and the resources available to an agency.23


21 Ibid., p. 343.

22 Echeverri-Gent states that three types of resources are important in policy implementation: economic, political, and informational. Business has great power over investment and the organization of the economy. While those elites choose the manner in which to dispose of their resources and have great influence, the government also has many resources at its disposal. Such state resources include credits, subsidies, licenses and regulations. Political resources of the state include legal sanctions and the ability to distribute resources so as to weaken opposition or strengthen support. Information is important to successful implementation and the government will depend on private parties for data not only during implementation but also during policy formation. Government agencies also possess major information resources, such as that concerning important regulations. Officials can use this resource as a weapon to reward friends or punish opponents. Ibid., pp. 350-351.

23 Ibid., pp. 360-361.
Charles A. Johnson and Bradley C. Canon propose a model for the implementation and impact of judicial policies. They define four populations or groups of actors apart from the initial decision maker that are active in judicial implementation. These are the interpreting population, the implementing population, the consumer population, and the secondary population. Johnson and Canon state that these classifications are functional and that individuals might be members of different populations at different times.

The interpreting population for an appellate decision consists of the lower courts (or government officials such as attorneys general) within the jurisdiction of the appellate court that apply that higher court ruling to their subsequent cases. The lower courts might broaden or limit the order as they interpret and apply it to matters that might not have been addressed in the appellate order.

The implementing population includes authorities whose actions may be approved or disapproved by the interpreting population in its application of the higher court ruling. These authorities might be public agencies such as the police or private agencies such as hospitals. When the implementer is a public agency, the court might require action such as the *Miranda* ruling in which the U.S. Supreme Court required police to advise those placed under arrest of their constitutional rights. When the implementer is private, the compulsion to act is weaker. For example, the Supreme Court has decided that women have the right to abortion but a private hospital would not be required to perform abortions against its will.

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25 Ibid., pp. 16-21.
The consumer population consists of those parties, usually private individuals, who might receive or lose benefits as a result of the appellate ruling. It may be very broad as in the instance of rulings dealing with income taxes or limited as with criminal suspects benefitting from the *Miranda* ruling.

The secondary population consists of everyone not included in the first three populations. Johnson and Canon distinguish among four subpopulations: government officials, interest groups, the media, and the general public. Government officials are legislative and executive officials who are not directly affected by the court decision but who could potentially aid or impede its implementation. Interest groups may be activated by court rulings that do not affect them directly and may also help or hinder implementation. General or specialized media might also have impact by their reporting of and editorial positions on the substance of the order. The general public subpopulation includes people who might be related to individuals in the consumer population, plus politically active and alert citizens.

In addition to these four populations, the authors define two types of responses to judicial decisions. The acceptance decision is the individual’s psychological reaction to a decision and may be acceptance or rejection. It includes several components such as attitude toward the policy before the court’s decision, regard for the court issuing the order, perceptions of any consequences of the decision, and the person’s role in society.

The second type of response is the behavioral response consisting of the actual reaction to the decision and determination of the extent to which the order is implemented. Behavioral responses are linked closely to acceptance decisions as those who do not accept a decision will try to

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26 Ibid., pp. 23-24.
evade it or minimize its impact while those who do accept it will be more enthusiastic. Policy changes including modification of the formal and informal rules and norms of an agency are one dimension of behavioral response. Another includes the actions of the interpreting and implementing populations involved in executing the policy. These acts will benefit or harm the consumer population and thus influence that group's decisions on whether to use or avoid the policy. Feedback to the originator of the policy or to some other agency is a third type of behavioral response noted by Johnson and Canon. The purpose of feedback usually is to "provide support for or make demands upon other political institutions regarding the judicial policy."²⁷

Subsystems

The literature includes discussions of various means by which outsiders can become involved in and influence an agency's operations. The first type of outsider involvement, agency participation in subsystems or subgovernments, has been debated at some length in the literature. The main point of controversy has been the nature of the subsystem arrangement: whether it is the rigid iron triangle or subgovernment that some authors claim or rather a looser issue network.

Agency involvement in subgovernments has been discussed by Randall Ripley and Grace Franklin who note that in some policy areas, such as distributive subsidy policies, subgovernments (consisting of agency officials, members and staffers from the congressional committees or subcommittees with principal or exclusive jurisdiction over that policy area, and representatives of interest groups) are very important factors. As these authors observe, most policymaking is routine (i.e. not

²⁷ Ibid., p. 25.
controversial) most of the time and thus subgovernments can function for long periods without outside interference. Such may not be the case in other areas of policy such as protective regulatory policy, however. This point is discussed further below.²⁸

Daniel McCool discusses subgovernment political viability which he defines as the ability of a subgovernment to influence policy to accomplish its goals.²⁹ He notes the importance of distributive policy and finds, when considering the participants in a subgovernment, that restructuring of congressional committees has resulted in subcommittee representation. In addition, appropriations subcommittees have shifted from cutting proposed budgets to making claims. Subgovernments may have a new ally in the appropriations subcommittees but the budget environment is more complicated with more actors including the budget committees, the entire House and Senate, and the Office of Management and Budget.

²⁸ See Randall B. Ripley and Grace A. Franklin, Congress, the Bureaucracy, and Public Policy, 5th ed. (Pacific Grove, CA: Brooks/Cole Publishing Company, 1991), pp. 6-8, 21. Ripley and Franklin state that the continued smooth operation of a subgovernment depends on the members being able to compromise among themselves on any disagreements about policy. This would avoid calling the attention of a broader audience that might interfere in the subgovernment's domain and operations. The authors also note two other ways in which a subgovernment might be opened up to outsiders. The President, other administration officials, or members of Congress might inquire into the arrangement's operations. These outsiders could make use of a variety of resources in their inquiry including the budget and legislative oversight. A third way in which a subgovernment might be opened up is the introduction of a new issue into its jurisdiction. The new subject might attract the attention of others and disrupt normal decision making. See Ripley and Franklin, pp. 7-8. These authors also state (p. 8) that a subgovernment "offers the most pervasive and effective channel" for interest groups to participate in program and policy decision making. Group impact will vary by policy area.

Subgovernments are thus forced to seek a wider power base in the Congress.\textsuperscript{30}

McCool discusses the importance of administrative agency structure. Structures that lead to greater agency autonomy (with less control by another agency or a parent department) are the most conducive to the subgovernment.\textsuperscript{31} Interest group participants in a subgovernment must fill two roles: constituents of Congress and constituents of administrative agencies. A group must be able to perform both of these functions, which may occasionally require different strategies.\textsuperscript{32}

As noted above by both Ripley and Franklin and McCool, subgovernments appear to function most effectively in distributive policies rather than in regulatory or redistributive policy. Ripley and Franklin describe protective regulatory policy and the conditions under which it is altered. Protective regulatory policy regulates private activities "for the presumed protection of the general public (or large parts of it)\ldots\textsuperscript{33}

Natural gas regulation would be an example. The authors state that the whole Congress interacting with top executive branch officials makes the main decisions on new areas to regulate or changes to be made in current regulations. In stable regulatory arenas, agency officials acting with members and staffers of House and Senate subcommittees can exert more influence and make final decisions on policy. Ripley and Franklin observe that even in this last case there are still greater chances for

\textsuperscript{30} Ibid., pp. 281-282.

\textsuperscript{31} Ibid., pp. 284-285.

\textsuperscript{32} Ibid., pp. 288-289.

\textsuperscript{33} Ripley and Franklin, \textit{Congress, the Bureaucracy, and Public Policy}, p. 103.
review of those decisions by higher authorities than would be the case in other types of policy.\textsuperscript{34}

The authors observe that instability in the protective regulatory policy arena results from the large number of interests involved. They state that:

Actors, being numerous, come and go as their interests are involved or not. They also change substantive positions. The coalitions that form usually do not extend beyond single regulated industries or sectors. This means that over time there is a kaleidoscopic aspect to the implementation of protective regulatory policy.\textsuperscript{35}

Thus, the importance of subsystems (or subgovernments) in the formation and implementation of regulatory policy may vary. These types of coalitions may form, but they may also be rather fragile.\textsuperscript{36}

\textsuperscript{34} Ibid., p. 106.


\textsuperscript{36} The assertion that arrangements vary by policy type is very important. Besides Ripley and Franklin and McCool, other scholars have made similar arguments. Goggin and his colleagues noted the importance of policy type in terms of the redistribution of costs and benefits required by a program. Richard Elmore argues that different types of problems call forth different types of responses from policymakers. Elmore defines four different types of responses or instruments: mandates, inducements, capacity-building, and system-changing. Each has its own operating characteristics and implementation problems. Mandates are rules that are intended to result in benefits for society as a whole and/or for specific individuals. This type of policy involves an adversarial relationship between the enforcers and the targets of the mandate. Examples are environmental regulations and nondiscrimination requirements.

Inducements are transfers of money to individuals and/or agencies in return for their performance of certain actions. They are (continued...)

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Other scholars have proposed alternative frameworks for subsystems, most notably Hugh Heclo who has described the issue network. Heclo states that it has become impossible to identify clearly the dominant actors in a variety of policy areas and that looking for the influential few results in overlooking many "whose webs of influence provoke and guide the exercise of power." The "webs" are the issue networks and include a large number of individuals (as contrasted with the small number of people in a subgovernment).

Unlike the subgovernment whose members need to cooperate in order to maintain that relationship, the participants in the issue network have differing amounts of commitment to or dependence on the other participants in the network. The boundaries between a network and its environment are oftentimes hard to discern. Heclo states that subgovernments and iron triangles have a stable set of members gathered around programs that are in the economic interest of the members. Issue network participants move in and out of those networks and no one is in

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36(...continued)
procurements with the recipients of the payments varying in their capacity to produce the sought outcome. Examples are grants-in-aid to governments. Capacity-building is the transfer of money to individuals or agencies, intended to be an investment in future intellectual, human, or material resources. An example of this type of policy would be government funding of basic research.

System-changing is the transfer of authority among individuals or agencies intended to modify the institutions used to deliver public goods and services. Examples would be using vouchers for certain government services or creating new providers of services such as health maintenance organizations. See Richard F. Elmore, "Instruments and Strategy in Public Policy," Policy Studies Review 7 (Autumn 1987): 174-186.

control of any programs or policies. Economic interests in programs are secondary to "intellectual or emotional commitment." The members of issue networks include not only interest groups but also individuals who may or may not be in government but who are known to be knowledgeable about the issues. Leaders of networks are "policy politicians—experts in using experts, victuallers of knowledge in a world hungry for right decisions."\(^{38}\)

Paul Sabatier agrees that the iron triangle model is too limited. He proposes a policy subsystem model that includes not only the actors of a subgovernment (agency, interest groups, congressional committee or subcommittee) but also actors at other levels of government that are involved in the policy area plus journalists, researchers, and analysts who generate policy ideas. A policy subsystem is thus defined as "the set of actors who are involved in dealing with a policy problem..."\(^{39}\)

Sabatier suggests grouping the large number of actors found in a subsystem into advocacy coalitions of people from different positions

\(^{38}\) Ibid., pp. 102-103. Heclo further characterizes an issue network as a "shared-knowledge group" dealing with an aspect or problem of public policy. Members are knowledgeable about an issue but are not necessarily unanimous in what public policy on that matter ought to be. Heclo states that issues are refined and data is evaluated in the networks. Policy options are then specified. All of these steps take place "though rarely in any controlled, well-organized way." See ibid., pp. 103-104.

McCool states that the issue network represents the null hypothesis. It exists when one cannot find a subgovernment. One can test for an issue network by testing for a subgovernment. He states also that the dominant thought in the revisionist literature appears to be that each corner of the iron triangle consists of many interests instead of one single participant. See McCool, "Subgovernments," pp. 290-291.

(governmental and nongovernmental) with a shared set of basic values and perceptions of problems (i.e., a shared "core" belief system). Each coalition shows "a nontrivial degree of coordinated activity over time." There will be a small number of coalitions within each subsystem, but not every actor in a subsystem will belong to an advocacy coalition. Policy brokers, who do not belong to any coalition, try to find solutions to policy problems and restrict the political conflict to an acceptable level. The courts are one example of policy broker.\(^{41}\)

Policy changes in subsystems have two main causes: first, advocacy coalitions trying to translate their beliefs into government programs; and second, external events. Sabatier states there will be one dominant coalition and one or more minority coalitions with each group trying to increase its political resources in order to achieve its objectives. However, external events, such as changes in socioeconomic conditions or outputs from other subsystems, will have impact on the resources of the subsystem actors.\(^{42}\)

Jeffrey Berry observes that there is an expanded universe of interest groups involved in policymaking in Washington and that these groups

\(^{40}\) Ibid., pp. 660-661, 663. Core beliefs will be very resistant to change due to "powerful ego defense, peer-group, and organizational forces" even if empirical findings run counter to the beliefs or other inconsistencies are present. Ibid., pp. 669-670. In this last point, Sabatier is rejecting the view that coalitions are formed out of short-term self-interest. As shown below, other authors (Jeffrey Berry) argue that it is such short-term concerns that motivate coalition formation.

\(^{41}\) Ibid., p. 662.

\(^{42}\) Ibid., pp. 670-671. For additional discussion and applications of the advocacy coalition approach, see Paul A. Sabatier and Hank C. Jenkins-Smith, eds., *Policy Change and Learning: An Advocacy Coalition Approach* (Boulder, CO: Westview Press, 1993).
are often in "open and protracted" conflict with each other. He argues that the parties in an issue network can gain much by pursuing a confrontational strategy because of their conflicting policy goals. Instead of attempting subgovernment style relationships, for example, interest groups might appeal to friendly legislators especially those seeking influence on policy (instead of reelection) to oversee vigorously and intervene in agency proceedings. Increased group conflict results in more group struggle in agency rulemakings. In addition, various congressional committees and subcommittees may try to influence the outcomes of agency proceedings. Berry notes that agency administrators, while trying to shape policy themselves, will be able to choose sides between the competing coalitions of their issue network."

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44 Ibid., pp. 247-253. Berry notes further that coalitions within an issue network form and reform constantly as "little premium is placed on being friends forever." As with Congress, new issues result in new divisions among the groups and new alliances are forged. Alliances are "strongly guided by the pragmatic needs of the here and now." See ibid., pp. 254-256.

Other studies touch on the points made by Berry. For example, Salisbury, Heinz, Laumann, and Nelson examined interest group alliances in the agriculture, energy, health, and labor policy areas. Interest group representatives and government officials involved in these issues and interviewed for the research responded that conflict in these areas was high but especially so in the energy and labor areas. Large majorities in all four areas were able to identify both interest group allies and opponents. See Robert H. Salisbury et al., "Who Works With Whom? Interest Group Alliances and Opposition," *American Political Science Review* 81 (December 1987): 1217-1234.

Browne's study of interest group activity in agriculture policy provides a somewhat different view, however. He found that groups carve out "issue niches" for themselves. A group will concentrate on a limited (continued...)
James A. Thurber states that subsystems are organized not to win elections but rather to make demands on the political system and to

“(...continued)


In a review article of some relevance to this discussion and to this research, Lee Epstein discusses group use of litigation to shape policy. She notes that more groups are using litigation to achieve policy objectives just as group activity in general has increased. Current cases "represent the struggle of interests to etch into law their broader policy views." Some have argued that groups litigate because court orders (especially those from the Supreme Court) have a permanency not found in legislation. Groups also litigate because their adversaries are doing so or they might not have the resources or status to achieve their objectives in the other branches of government. See Lee Epstein, "Courts and Interest Groups," in *The American Courts: A Critical Assessment*, eds. John B. Gates and Charles A. Johnson (Washington, D.C.: CQ Press, 1991), pp. 335-371 at pp. 343-345, 351-356.

As the Epstein article illustrates, litigation can be part of the group struggle and interaction in a policy subsystem. Martin Shapiro describes the use of litigation as a bargaining tool in the relationship of the Interstate Commerce Commission with truckers and railroads. He notes that each party can use the option of appealing to the courts as part of its bargaining strategy with the anticipated outcomes of such litigation being useful to some parties and harmful to others. A party that litigates can force the decision of issues that the agency might not want decided at that moment and thus can help or hinder the agency by deciding when or what to take to court. See Martin Shapiro, *The Supreme Court and Administrative Agencies* (New York: The Free Press, 1968), pp. 62, 265.

Increased group use of the courts does not necessarily mean that groups are overwhelmingly successful as Epstein points out in a research note focusing on federal district court cases. See Lee Epstein and C. K. Rowland, " Debunking the Myth of Interest Group Invincibility in the Courts," *American Political Science Review* 85 (March 1991): 205-217.
influence programs. He defines a subsystem as a decentralized power structure with a membership very similar to that specified by Ripley and Franklin for subgovernments (interest group representatives, members and staff from Congressional committees and subcommittees, agency representatives). Thurber includes other actors besides this core: policy specialists from other levels of government and universities plus the media and presidential advisers. Subsystem participants develop expertise and relationships with one another.

Like subgovernments, Thurber's dominant subsystems are stable, include a small number of participants, and are mainly concerned with distributive policies. Competitive policy subsystems are characterized by competing coalitions of actors. The competition might last for years and usually involves policy jurisdiction as well as the substance of a program. This type of subsystem arrangement usually characterizes redistributive or regulatory policy areas.

In a review article, Keith Hamm describes the leading characteristics of functional subsystems. These include internal complexity, functional autonomy, unity within type of participant, and cooperation or

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46 Ibid., pp. 323, 325.


48 Ibid., pp. 330-332. An example of an institutionalized competitive subsystem offered by Thurber is the conflict between industry and environmentalists over the Clean Air Act. Similar to the points made by Ripley and Franklin, Thurber notes that subsystems must resolve conflict in order to survive. If the members cannot resolve the dispute, outsiders will become involved, increasing their influence and the chances of changing policy. Thus, the members of a subsystem will want to control the scope and level of conflict. See ibid., pp. 336-337.
conflict among different participants. Internal complexity refers to the number and variety of subsystem participants. A less complex system might include a small number of important individuals while a more complex system could involve many agencies and interest groups. Change within a policy area may result in a subsystem moving from one end of the complexity continuum to the other. Functional autonomy means the extent to which a subsystem formulates and implements policy without interference from other subsystems, the public, or other outsiders. Autonomy will vary with policy type. Unity means the extent of agreement or disagreement among the individuals from each part of the subsystem: interest groups, agency, and committee. Cooperation or conflict among different participants will also vary with policy type.49

Some scholars have proposed models exclusively for regulatory policy that are based on issue networks and subsystems. Two such models are discussed here: Gormley's regulatory issue networks and Meier's regulatory subsystem. William Gormley's argument is that regulatory politics varies across issue areas depending upon two main factors: public salience and technical complexity. An issue that is highly salient is one that affects many people significantly. An issue that is highly complex requires specialized knowledge and training to answer the factual questions surrounding it.50

49 See Keith E. Hamm, "Patterns of Influence among Committees, Agencies, and Interest Groups," *Legislative Studies Quarterly* 8 (August 1983): 379-426 at pp. 381-382. Similar to this last point, Hamm also notes that the relationship between an agency and its congressional committee will vary with the type of policy, the stage in the policy process, the type of committee, environmental constraints, and issue characteristics. See pp. 406-409.


(continued...)
Different combinations of salience and complexity result in different regulatory issue networks. Gormley defines four such combinations: board room politics, hearing room politics, street-level politics, and operating room politics. In board room politics, complexity is high while salience is low. The public is not involved and policy will be made by bureaucrats, professionals, and business groups. Key decisions will be made by corporate executives.\(^{31}\)

The combination of high salience and low complexity results in hearing room politics. This area is marked by high involvement by a mobilized citizenry and by politicians and extensive coverage by the media. Major decisions are made in legislative hearing rooms with the public and interest groups making their views known. Street-level politics consists of low salience and low complexity issues. Citizens and politicians are not involved and thus lower-level officials and regulated firms are dominant.

Operating room politics consists of high complexity and high salience, creating pressure for both expertise and accountability. Citizens' groups will be active while the actions taken by politicians will be mainly procedural (creating new agencies or reorganizing existing ones) instead of substantive. The major decisions will be made by upper level

\(^{30}(...continued)\)
Gormley states that both salience and complexity may change over time. Salience may change if a problem worsens or improves, demographic conditions change or a policy entrepreneur redefines an issue. Changes in complexity do not occur as readily as those in salience but are still possible. Conditions for modification in complexity are a new technology creating new policy options, changes in the amount of competition in an industry resulting in more or less of a need for regulation, and redefinition of an "optimizing" task as a "satisficing" task or vice versa. See p. 599.

\(^{31}\) Ibid., pp. 606-608.
bureaucrats who can claim both legitimacy and expertise. Gormley notes, however, that there will be second-guessing of these officials’ decisions if results are not acceptable. Dissatisfied parties may be very likely to seek judicial intervention.\footnote{\textsuperscript{52}}

Kenneth Meier agrees with the point that the iron triangle model of policymaking could not apply to regulation, noting for example the disagreements among the various involved interest groups. Meier’s model includes industry groups and other interest groups, significant others such as journalists and researchers, state governments, the regulatory agency, and the legislative subcommittee.\footnote{\textsuperscript{53}}

Meier observes that regulatory agencies are not passive actors. Regulators work to attain their own policy goals although an agency might be plagued by a lack of consensus on goals to be pursued. An agency’s resources include its expertise, its cohesion, its statutory authority, its leadership, and the salience of the regulatory issue. If the agency has these resources, it will be able to play a greater role in shaping policy. If it lacks these resources, policy will be shaped by the interaction of the various advocacy coalitions of the subsystem.\footnote{\textsuperscript{54}}

\footnote{\textsuperscript{52}} Ibid., pp. 611-615.


\footnote{\textsuperscript{54}} Ibid., pp. 14-18, 35. Where policy is shaped by the interaction of the advocacy coalitions, Meier notes that the direction that regulatory policy will pursue will depend mainly on the goals of the dominant coalition. If that coalition is an industry coalition, regulation will favor the industry. If the dominant coalition is nonindustry, then regulation will favor the nonregulated opponents of the industry. If the coalitions are balanced, regulation will be balanced. The cohesion of the industry is also important because that will affect the power of the industry coalition. If the industry is not cohesive, regulation will more likely favor the nonregulated. See ibid., p. 35.
Meier states that agencies do have some discretion in policymaking but that it is dependent on the agency’s resources and the toleration of other actors. Each actor has a "zone of acceptance" and no action will be taken against the agency if its policies fall within that zone. The actors within the subsystem will have a narrower zone than those from the broader political system outside the subsystem. Policies pursued by the agency that are within the zone of acceptance of Congress, the President, and the courts will preserve subsystem autonomy because those actors will be satisfied. Actions outside of the zone will result in intervention from those outsiders.\textsuperscript{55}

\textsuperscript{55} Ibid., p. 18. Using Gormley’s criteria, Meier states that the size of the zones of acceptance will vary with both salience and complexity. Salience will increase the benefits of intervention while complexity will increase the cost. Thus actors will be most likely to intervene in policies that are salient but not complex. See ibid., p. 18.

Meier’s description of the agency’s role in the regulatory subsystem and the limits on its discretion placed by others (i.e. their toleration and "zones of acceptance.") relates to Francis Rourke’s discussion of an administrative agency’s mobilization of political support and development of a constituency for itself.

Rourke states that "a vital source of power for administrative agencies is their ability to attract the support of outside groups." Depending too heavily on support from outside groups, however, may result in the outsiders acquiring a veto over an agency’s actions. The agency, if it is not careful, could become captive to the outsiders, although Rourke notes that capture is most likely when the agency deals with a single-interest constituency.

Agencies without strong support from outside groups may try harder to foster good relations with Congress although Rourke notes that agencies with strong outside support certainly will not neglect Congress. Agency administrators may try to convince authorization and appropriation committee or subcommittee members of the validity of the agency’s point of view in hopes that these legislators can become the agency’s spokespersons in Congress. See Francis E. Rourke, \textit{Bureaucracy, Politics, and Public Policy}, 2d ed. (Boston: Little, Brown and Company, 1976), pp. 42, 44-55, 61-62.
Congressional Oversight/Congressional Dominance

In addition to subsystems the literature covers several other means by which external actors can influence bureaucratic behavior. Some of these are covered briefly below. Legislative oversight of agency operations including the question of whether Congress can impose its will upon or dominate agencies is discussed first.

Two older studies of congressional oversight are those by Seymour Scher and Morris Ogul who discuss the conditions under which Congress would oversee agency operations. Scher characterizes oversight as "a spasmodic affair marked by years in which the agencies are virtually ignored followed by spurts of committee interest in agency activity." The conditions encouraging oversight include a chance to embarrass a president of the opposite party, the failure of routine personal contacts with agency officials to satisfy important constituent or group interests, perceived threats from the president to traditional congressional prerogatives of primacy in relation to the independent regulatory commissions, an interest in Congress in revising regulatory policy, and an attempt to block an inquiry being planned by unfriendly interests (unfriendly to committee leaders and the agency) to expose agency failures.

Important factors, as noted by Ogul, in determining the extent of oversight include the subject matter involved especially its visibility. Oversight is more likely to be undertaken if members of Congress can expect increased political visibility for themselves to result from such an

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58 Ibid., pp. 540-550.
Another factor is congressional confidence in the agency and its leadership. Less confidence may lead to more oversight. Member priorities are another important factor relating to oversight. If a member assigns a high priority to a policy area, he/she will be more likely to engage in oversight of that area.  

A more recent examination of legislative oversight was done by McCubbins and Schwartz who distinguish between police patrol oversight and fire alarm oversight. Police patrol oversight is centralized and active. Congress examines agency actions at its own instigation in order to detect, remedy, and discourage executive branch violations of legislative goals. Fire alarm oversight is (from the congressional standpoint) less centralized and less active. Individuals and interest groups use the system of rules and procedures established by Congress in legislation to examine agency actions and find violations of congressional intent. These groups and individuals may then seek action from Congress or from the courts or agencies. The role of Congress is to establish the decentralized system used by other actors and to intervene occasionally in response to complaints.

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59 Ogul, *Congress Oversees the Bureaucracy*, pp. 15-16, 20. A third classic study of oversight is that done by John Bibby on the Senate Banking and Currency Committee. Bibby found that several different factors promoted active oversight. These included a committee chair who did not restrict but instead assisted member activities (i.e. acted as a "service chairman"), autonomous subcommittees, adequate staff numbers and staff specialization, higher member interest in committee work, and viewing the committee as more than a processor of legislation. See John F. Bibby, "Committee Characteristics and Legislative Oversight of Administration," *Midwest Journal of Political Science* 10 (1966): 78-98.

McCubbins and Schwartz argue that Representatives and Senators will prefer fire alarm oversight because they will not have to take action unless their supporters have complained (sounded alarms). Also, many of the costs of fire alarm oversight will be borne by the citizens and groups that sound the alarms, by the agencies and by the courts.61

In a discussion of the scholarship on oversight Morris Ogul and Bert Rockman note the problems of operationalization, especially in the case of anticipatory behavior by the executive branch. An agency might comply with legislative intent because of "subtle signals" from congressional overseers. Overt oversight activities are easiest to measure while it is hard to prove that the anticipatory forms of latent oversight actually

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61 Ibid., pp. 167-169. McCubbins and Schwartz argue that scholars who allege that Congress is neglecting its oversight responsibilities have mistakenly concentrated on police patrol activities and excluded fire alarm oversight. They acknowledge that members themselves might not refer to fire alarm oversight as actual oversight. However, there would be no reason to respond to the alarms unless Congress sought to detect and remedy agency violations of legislative intent, the authors' criteria for oversight. See ibid., pp. 170-171. For the difficulties of implementing police patrol oversight in one state (North Carolina), see Cheryl M. Miller, "The Politics of Legislative Curtailment of Administrative Rule-making: Obstacles to 'Police-Patrol' Oversight," Policy Studies Review 6 (May 1987): 631-644.

Banks and Weingast have proposed a model that incorporates some models of fire alarm oversight. They state that interest groups are valuable to a politician because they can police agencies and enable any rewards from an agency to accrue to the politician. See Jeffrey S. Banks and Barry R. Weingast, "The Political Control of Bureaucracies under Asymmetric Information," American Journal of Political Science 36 (May 1992): 509-524.
Ogul and Rockman state that the purpose of oversight is "to ensure that those to whom authority is delegated remain responsive." A theory of "congressional dominance" has emerged in the literature as an attempt to describe and conceptualize the relationship between Congress and the bureaucracy. Terry Moe states that the foundation of congressional dominance theory is the argument that members of Congress desire reelection. The committee system (both in terms of the structure and the membership of committees) reflects this motivation and legislators will use their committee positions to influence the behavior of others.


63 Ibid., p. 7. They then ask the logical question of "responsive to whom or to what?" and present several possibilities. These include responsive to professional norms, to internal constituencies, to public interest constituencies, to committee preferences, to Congress as a whole, and to multiple principals. See ibid., pp. 7-12. The authors state that since 1970 there would appear to be more reasons for a legislator to engage in oversight including more distrust of government by the public, divided government at the federal level, declining resources, and decentralization in Congress. Ibid., pp. 18-20.

West and Cooper critique a new model of oversight that seeks to emphasize the role of the Presidency over that of Congress. According to this model, the President should play the active role because he or she is elected by a national constituency and thus represents broader majoritarian interests. Congress, on the other hand, is fragmented and represents narrow special interests. The authors argue that executive oversight, as shown by the Reagan administration, may not represent a national mandate but rather may reflect the interests of those groups that are in constant contact with the White House. While Congress is indeed fragmented and does often represent narrow interests through its committee structure, that does not mean that the legislature does not take broader concerns into account.

agencies to their electoral benefit. Members will be unconcerned with bureaucratic behavior except to the extent that it affects benefits for their constituents. Agencies will try to avoid Congressional sanctions and will thus stay in line.

Mathew McCubbins has employed the principal-agent framework to model the use of institutional arrangements used by Congress (the principal) to constrain a regulatory bureaucracy's (the agent's) discretion. In his model, the motivation to delegate authority to an agency is a given. By choosing to delegate, however, Congress will encounter two problems: shirking and slippage. Shirking occurs when the agent pursues its own goals instead of the principal's preferred objectives. Slippage refers to problems of design and operation. It may not be possible to choose the exact arrangement that provides a perfect translation of congressional objectives into agency policy.

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65 Ibid. Moe states that because agencies are "so nicely under the thumb of Congress," dominance theory asserts that understanding bureaucratic behavior requires understanding Congress and its internal processes instead of agencies and their processes. See ibid., p. 478.


67 Ibid., p. 724. Congress can use a variety of means to respond to these problems. These include defining the institutional setting of the regulatory activity (for example, independent commission or executive agency), specifying the scope of the authority delegated and the targets of the regulation, specifying procedural requirements such as hearings and standards of evidence, and using appropriations and oversight to try to insure compliance. Ibid., pp. 725-729.
Moe offers some critiques of the congressional dominance literature in his previously mentioned review article. He notes that the theory could make use of the principal-agent framework as McCubbins has done. However, Moe states that this framework focuses generally on one principal and one agent to the neglect of the many other legislative and executive branch principals to whom an agency might be accountable. These many principals will probably be competing among themselves for influence over the agency which might then be able to play one off against the others. A simple principal-agent analysis would exclude this maneuvering.  

Moe also raises questions about fire alarm oversight in a discussion of what congressional "control" means. He notes that one interpretation is that Congress sets the limits and that the agency is responsive to legislative wishes because it does not want to set off any alarms. Agencies voluntarily submit to the will of Congress by anticipating congressional intent even though Congress might not be watching very closely. However, constituents might complain about only a small part of what an agency does (i.e. only those actions that impact on their daily lives). Congressional control through constituent fire alarms thus might apply to only a minor subset of agency actions.

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[69] Moe, "An Assessment," p. 485. Woolley argues that a regulator can have very broad discretion to make policy choices especially in the case of a bicameral legislature with different parties controlling the chambers. Determining factors will be the ideological distance between the overseeing committees in the two houses and the distance between each committee and the ideological floor median of its house. As those distances increase, so too will regulators' discretion. Even with the same party controlling both chambers, regulators still have some discretion to adopt policies that stray from the median of the oversight committees. See John T. Woolley, "Conflict Among Regulators and the Hypothesis of (continued...)"
Principal-Agent

Other uses of the principal-agent framework, above and beyond the theory of congressional dominance, are covered in this section. For example, B. Dan Wood analyzes the response of the U.S. Environmental Protection Agency to outside pressures during the Reagan administration focusing on EPA enforcement of the Clean Air Act during the first Reagan term (1981-85).^69

The variables studied are President Reagan's first inauguration, the fiscal 1982 reduction in the EPA budget, and the resignation in March 1983 of EPA Administrator Ann Burford.^70 Wood concludes that the principal-agent model of agent obedience to the principal's will does not account for the actions of the EPA. Counter to that model's expectations, the agency increased its activities immediately after President Reagan's inauguration and abatement activities increased soon after the 1982 budget took effect even though there was an initial decline. Only when Congress agreed with the White House in the form of the budget cuts of fiscal 1982 was the agent reined in by its White House principal. Wood states that a consensus of multiple principals, a coarchy, is needed to produce an effective hierarchy. The principal-agent model is not


entirely effective here because it did not take into account sufficiently EPA interests and abilities to shape policy.  

Marc Eisner and Kenneth Meier analyze the Reagan administration's impact on the Department of Justice's antitrust policy, using both the principal-agent framework and a bureaucratic politics perspective. Their principal-agent hypotheses are that presidents can influence antitrust policy by appointing key officials who then shape the agency and its incentives; that the Antitrust Division will reflect any shift to the left or to the right of the ideological positions of Congressional subcommittee members; and that in response to the economy the Justice Department

72 Ibid., pp. 228-229. Wood debated his findings and other topics relating to principal-agent models with Brian Cook in a later issue of the American Political Science Review. Cook maintained that Wood had not sufficiently incorporated the impact of Congress in his model. The variable that Wood used, the fiscal 1982 budget, was a joint executive-legislative venture and thus did not represent the legislature's independent influence. Wood's model did not "capture the essence of Congress as principal in a democratic hierarchy" because it ignored the roles of committees and subcommittees and the long-term interactions between those legislative units and executive agencies. Budgetary and authorizing committee influence would have to be incorporated into the model.

Wood responds that the EPA could not have been reacting to signals from Congress when pursuing the course that he had found. He notes that the leaders of the relevant committees in the Republican controlled Senate in 1981 were less supportive of the environment and the agency than their Democratic predecessors had been. The Senate had approved the Reagan appointees who were hostile to the EPA and its programs and appropriations committees had approved cuts in the agency budget even after 1982.


will file more cases as inflation and/or unemployment increase. Their bureaucratic politics hypothesis is that any change in antitrust policy during the Reagan administration was merely a continuation of hiring trends (more economists who were adherents of the Chicago School view of limited government intervention) that predated Reagan's term.

The authors examine three types of antitrust cases, price fixing, monopoly, and mergers. The influence of the Chicago School would be seen with declines in monopoly and merger cases and increases in price fixing cases. They find that the proportion of price fixing cases was unaffected by the President, Congress, and economic factors while the addition of economists in the Economic Policy Office had a large impact. The unemployment rate and the creation of the economic office were the important factors for monopoly and merger cases. The authors conclude that the changes in antitrust policy during the Reagan administration were due to the bureaucracy rather than to any influence from external political actors. Bureaucratic evolution and the professional values of the economists hired by the Justice Department were key factors.

Krause examines dissenting votes cast by members of the Federal Open Market Committee (FOMC) of the Federal Reserve System between January 1967 and December 1990 in order to assess the influence of both internal (the Fed Chair) and external (the President) principals on a multiagent bureaucracy. The factors hypothesized to result in consensus are the number of FOMC members appointed by or during the

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74 Ibid., pp. 274-275.

75 Ibid., pp. 276-277.

76 Ibid., pp. 280-283.

current presidential administration, appointed by or during the same party as the current president, and appointed during the tenure of the current Fed Chair. Greater numbers of members falling into each category should lead to greater consensus and thus less dissent on the FOMC. The first two factors are used to measure the external principal’s influence while the third factor measures the influence of the internal principal.78

In his analysis of the FOMC, Krause distinguishes between members who belong to the Board of Governors (BOG) of the Federal Reserve System and members who are regional bank presidents (RBP).79 He concludes that there is presidential influence on BOG but not RBP dissenting. Presidents can build support for their policies over time however, the internal principal, the Fed Chair, had greater impact than did the external principal on the consensual decision making of both types of agents.80

78 Ibid., pp. 129-131.

79 The BOG members are appointed by the President and fill seven of the twelve positions on the FOMC. The RBPs are appointed to their bank presidencies by the board of directors of each Federal Reserve bank. Four of the five RBP positions of the FOMC rotate on an annual basis among the various banks while the New York Federal Reserve Bank president fills the fifth position on a permanent basis. See ibid., pp. 125-126. Krause finds greater presidential impact on BOG dissent than RBP dissent indicating to him that presidential powers of appointment along with persuasion are key to any presidential influence instead of just persuasion alone. As noted above, the President appoints the members of the Board of Governors but not the regional bank presidents. Thus, the distinction was made between appointment by and appointment during the current administration. Those appointed during the president’s term (the regional bank presidents) would be subject to persuasion or nonappointment pressures only. Krause suggests that both types of pressures are needed for presidential influence. See also pp. 134-138.

80 Ibid., p. 140.
Other Studies

Two studies by Terry Moe include findings of substantial influence by external factors especially the presidency on agency decision making. In the first, Moe analyzes presidential influence on three independent regulatory commissions, the National Labor Relations Board (NLRB), the Federal Trade Commission (FTC), and the Securities and Exchange Commission (SEC), from 1948 to 1977.® He finds that NLRB decisions did shift in an anti-union direction during the Eisenhower administration, in a pro-union direction during the Kennedy-Johnson years, and back in an anti-union direction during the Nixon-Ford administrations. There were also differences across administrations for both the SEC and the FTC with Republican presidents showing more vigorous antitrust enforcement and regulation of business. He concludes that presidents do have some impact in shaping the policies of the independent commissions.®

In another analysis exclusively of the NLRB, Moe considers the influence of internal and external factors on Board decisions from 1948

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® See Terry M. Moe, "Regulatory Performance and Presidential Administration," *American Journal of Political Science* 26 (May 1982): 197-224. Moe makes the interesting observation, particularly relevant to the discussion of subsystems, that regulatory agencies are "enmeshed in an intricate web of interrelationships" and thus their actions can help to cause themselves. See p. 204.

® Ibid., pp. 207-217, 218-221. Similarly, B. Dan Wood finds "demonstrable differences" between Democratic and Republican administrations in the implementation of equal employment policy. For example, cases rejected by the Equal Employment Opportunity Commission's district offices as being without merit increased under Nixon-Ford, decreased under Carter, and increased again under Reagan. See B. Dan Wood, "Does Politics Make a Difference at the EEOC?" *American Journal of Political Science* 34 (May 1990): 503-530.
The internal "endogenous core" consists of the Board members, NLRB staff members, and the constituent groups (firms, unions, workers). Moe notes the dynamics of this core. The Board can make decisions only on the cases that the staff passes up to it while the staff can only act on those cases filed by constituents. The staff will make filtering decisions on the basis of past Board actions. Constituent filing will be based on perceived likelihood of success which is affected by those groups' perceptions of any changes in Board and staff decisions.

The exogenous variables consist of the three main political principals or branches of government. Moe assumes that a change to a Democratic president should result in a prolabor NLRB shift while a change to a Republican president should result in a probusiness NLRB shift. He also assumes that the Board will be more prolabor if the chairs and members of the relevant congressional committees are more liberal and if the courts tend to overturn the Board in favor of labor.

In analyzing Board decisions, Moe finds that the changes in presidential administration produced the expected results while prolabor signals from Congress and the courts also had a positive correlation with prolabor decisions from the Board. Three economic conditions were also important: unemployment (higher unemployment correlated with prolabor decisions), inflation (lower inflation correlated with prolabor decisions), and strike activity (higher strike activity correlated with prolabor decisions although statistically insignificant). Filtered caseload had a negative impact. Moe interprets this finding as evidence of an internal

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84 Ibid., pp. 1097-1098.

85 Ibid., p. 1102.
equilibrating mechanism: filtered case load contained an increased number of cases filed by labor and thus the average merit of such cases declined relative to those filed by business. Board decisions thus shifted in a probusiness direction.  

Court-Agency Interaction

The interaction between the courts and administrative agencies is the final major topic to be considered in this review. Some of the major theoretical work here has been done by Martin Shapiro. In The Supreme Court and Administrative Agencies, published in 1968, Shapiro asserts that courts and agencies are both supplementary lawmakers and that conflict between them is not inherent or inevitable. He discusses the conditions for judicial review of agency actions, stating that in some instances the more general perspective of the judiciary will result in better policy although in other cases the specialized knowledge of the agency is the better choice. Courts should not intervene when the agency is capable of making a sound decision and they should also not intervene when the specialist has maintained proper

86 Ibid., pp. 1108-1109. Further analysis conducted by Moe finds that presidential impact (partisan change in administration) on Board decisions is greater than that of any of the nonpresidential factors. See table 3 and discussion in ibid., p. 1110.

Moe examines staff case filtering decisions and finds that previous Board decisions constitute the dominant factor. He states that staff is guided more by hierarchical control and the mix of cases filed than by economic forces. He finds that constituent filing decisions are impacted by both staff filtering decisions and Board formal decisions. See ibid., pp. 1111-1114.

87 See Shapiro, The Supreme Court and Administrative Agencies, pp. 92-93.
perspective. The nature of the policy issue is not the only important factor here, but also the attitudes of the agency.\textsuperscript{88}

An instance in which courts should intervene results from the position of both the judiciary and agencies as supplementary lawmakers, subordinate to the statute maker.\textsuperscript{89} When the statute maker approves a law with clear provisions, an agency is expected to make and refine policy within those guidelines. Congress does not have the time or resources to keep constant watch over a particular agency, but the courts are in a position to notice and to thwart any agency moves to subvert legislative intent. Shapiro states that "it was therefore natural for the statute maker to set its judicial subordinate to watch its administrative one."\textsuperscript{90}

In other cases the statute maker may approve a law with few restrictions, granting wide discretion to the agency to make policy. Such laws might be "open invitations to all supplementary lawmakers to make large amounts of law" to fill in the statutory gaps. But it would be "unwise" to allow the agency exclusively to define its powers. The courts can provide "a useful surveillance, reporting, and delaying mechanism" as they themselves help to fill in the gaps in the law. Congress assumes that

\textsuperscript{88} Ibid., pp. 97-98.

\textsuperscript{89} Shapiro defines "statute maker" as more than just the Congress. It also covers the legislative actions of the President and the executive branch (the drafting of bills and formulation of legislative programs). The term is a "simplifying device reflecting a complex reality." For Shapiro, the statute maker is the entire legislative process that results in the laws that are implemented and interpreted by agencies and courts. See ibid., pp. 18-20.

\textsuperscript{90} Ibid., pp. 99-100.
judicial review will operate on the agency. Such review will provide a signal to Congress to reconsider and refine the law.\(^9\)

In *Who Guards the Guardians?*, published in 1988, Shapiro describes various movements in philosophy, political theory, and administrative law that were reflected in judicial rulings imposing certain requirements on administrative agencies.\(^9\) Reflecting pluralist views of the public interest, the courts in the 1960s and the 1970s required agencies to allow input into rulemaking proceedings by all interested groups. A "dialogue" requirement was imposed as agencies were to respond to every significant argument made by all groups presenting comments. This

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\(^9\) Ibid., pp. 100-102. In discussing the roles of courts and agencies as supplementary lawmakers, Shapiro states that the courts as loyal subordinates will try to insure that questions that the judges feel Congress would want to reconsider are indeed sent back to the legislators. Courts might also approve agency attempts to expand their powers as long as they are small steps rather than large scale changes. By slowing an agency's moves in a certain direction with only partial approval, the court would keep "the political situation more fluid" and allow opponents to try to reverse the policy in proceedings before the agency, in Congress, or in court. See ibid., pp. 241, 246-248.

Shapiro also discusses the use of remands by courts, an important topic for considering judicial interaction with the FERC or many other agencies. He notes that when courts remand matters back to the agency for further consideration, the judges do so not because of any "loose ends" but rather because they disagree with the policy reflected by that decision. The agency might refine the arguments and present the court with the same policy. Remands are useful because they allow for subtle communication between the court and the agency. The judges do not have to approve or reject the agency's actions outright. Instead, the court is telling the agency that it disagrees with the policy. However, it will not stop the agency if it reconsiders and still wants to proceed after taking the judges' views into account. See ibid., pp. 132-133.

was later modified by the late 1970s to require agencies to respond merely to all significant issues.\footnote{Ibid., pp. 46-51.}

This change signalled the move to postpluralism and synoptic rule-making. Adherents of synoptic policymaking seek rationality or efficiency instead of pluralist group struggle as criteria for policy. Synoptic decisionmaking entails acquiring necessary or relevant data, considering alternatives and their consequences, and then making a decision.\footnote{Ibid., pp. 15, 51-54.}

This synoptic requirement to acquire data on and analyze all major options in a rulemaking eventually weakens the position of the courts with respect to the agencies. Initially the agencies will not be equipped to make synoptic decisions and courts are in a position to overturn rules as not being sufficiently synoptic. As time moves on, however, agencies will employ better procedures and make better decisions. Judges thus "find it increasingly difficult to exercise review over the highly technical records they have demanded."\footnote{Ibid., pp. 153-155.}

After synopticism, the next major decisional mode that Shapiro discusses is prudence. Aware that demonstrable truths about values and simple laws about government action on problems cannot be found, adherents of prudence assert that people can learn enough about facts and values to make sound judgments about personal matters and public policy.\footnote{Ibid., pp. 135-136. Shapiro states that synoptic administrators cannot be prudent because "there is nothing to be prudent about." They only need to find the correct solution to a problem. Ibid., pp. 138-139.} Judicial review is easier under a prudential standard as judges will have to exercise their own prudence in order to oversee agency prudence. For Shapiro, prudence and the judge as "senior prudent"
expose the undemocratic nature of judicial review more than synopticism and most acutely raises the question of "who guards the guardians?" Case by case adjudication (prudence is exercised on a case by case basis) will not serve to limit judicial discretion.

Daniel Fiorino has studied the interaction between the courts and the Federal Power Commission over natural gas policy from 1969 to 1975. He states that "at its most concrete level, judicial-administrative interaction refers to the exchange of opinions and orders between court and agency." He argues that the interaction between a court and an agency involves more than just the exchange of opinions and orders, however. Agency officials will discern how the courts will probably react to a policy change even before they introduce the change. Relationships between courts and agencies are recurring, cumulative, and anticipatory. An agency may justify any proposed changes in policy as being necessary because of changing circumstances but still within the range of flexibility permitted by previous court decisions. In addition, anticipation of a negative court response may prevent an agency from considering some policy options.

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97 Ibid., pp. 160-162. Shapiro feels that in the future courts will acknowledge openly that they are checking agency prudence with their own prudence and not with synoptic rationality. He asserts that judges are not any more prudent than the people and that the people should let judges know that they realize that. Shapiro argues that informing the courts thusly will guard them from unduly substituting their prudence for that of others more directly answerable to the people. See ibid., p. 173.


99 Ibid., pp. 86-87. Fiorino states that courts can learn from agencies. Agencies may lecture to the courts in their opinions, briefs, orders and oral argument, instructing the courts on the need for change in policy.
Another facet of the ongoing relationship between courts and agencies is noted by R. Shep Melnick in his study of the interaction among the federal courts, the U.S. Environmental Protection Agency (EPA), interest groups, members of Congress, and the executive branch growing out of EPA enforcement of the Clean Air Act. Melnick discusses the importance of the federal judges' views of the EPA, finding that the judges often based their decisions in the cases studied on their preconceived views of the agency.

One such view adopted by some circuit court judges was that of a "generally competent but occasionally careless" agency. The other major view was that the EPA was "an agency wielding great power over private citizens and the entire economy, bent on extending its authority, single-mindedly devoted to protecting the environment...."100

The judicial process reinforces the stereotypes because environmental and industrial groups engage in forum shopping, finding courts that share their views. Judges subscribing to the "competent but careless" view of the EPA could stress the benefits of regulation while the judges worried about excessive government regulation of the private sector could stress due process requirements.102

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101 Ibid., p. 372.

102 Ibid. In his discussion of participants in regulatory issue networks, Gormley notes that judges will be most likely to intervene in disputes involving highly salient issues. Greater impact from a regulatory agency decision increases the likelihood of judicial intervention. He notes further that judicial reversal of agency action is more likely in cases involving highly complex issues despite the lack of judicial expertise in such matters. This is so for two reasons. First, in cases involving issues of low complexity politicians are more willing to make policy and thus (continued...)
The final topic to be considered here is the impact of type of agency on judicial review. Crowley examined the question of whether the level of support for a regulatory agency in its appearances before the Supreme Court was affected by whether it was an "old style" economic regulatory agency (such as the Federal Communications Commission or the FERC) or a "new style" social regulatory agency (such as the National Labor Relations Board or the Environmental Protection Agency). His analysis covered the Burger Court from 1976 to 1983.103

Crowley found slightly greater support for the economic agencies than for the social agencies (79.1 percent favorable rulings for economic vs. 68.3 percent for the social). The difference was not as great as anticipated and thus could not lead one to conclude without question that type of agency does matter. He also found the conservative justices to be less supportive of the social agencies generally although those justices were more supportive than liberal justices of conservative decisions from both the economic and social regulatory agencies. Liberal decisions from the agencies were supported more by the liberal justices.104

Sheehan also examines the question of agency type in an analysis covering 1953 to 1988. He found an even smaller difference in the success rates of economic and social agencies at the Court: 73.4 percent for the economic and 74.6 percent for the social. Like Crowley, he then

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102(...continued)
there will be a clearer connection between the legislation and administrative policy. Second, politicians are more willing to impose procedural constraints in highly complex issue areas. Such constraints, if violated, allow judges to reverse agency decisions without considering the technical merits. See Gormley, "Regulatory Issue Networks," p. 604.


104 Ibid., pp. 270-276, 279.
analyzed conservative and liberal decisions by the agencies. Liberal justices were more supportive of liberal agency decisions and conservative justices were more supportive of conservative decisions. Sheehan concludes that future research should be more concerned with the type of policy originating with an agency rather than the type of agency.\textsuperscript{105}

**Conclusion**

This section contains a brief summary of the reviewed literature and a discussion of its implications for framing this research. As shown above, scholars have identified a variety of factors important in the implementation of policy including the dispositions and commitment level of agency officials, conflict within the agency over policy goals, the amount of change required by the policy, the perceived legitimacy of


In a second analysis, also covering 1953 to 1988, Sheehan introduces the distinction between independent regulatory commissions and executive branch regulatory agencies (while retaining the economic/social dichotomy). He hypothesizes that the Court might be more supportive of the independent commissions because of their quasi-judicial processes and their insulation from presidential politics. The independent agencies do indeed have higher success rates in both the economic and social policy areas.

Sheehan finds that generally the Warren Court was more supportive of liberal decisions from the agencies (across the various categories of agencies) while the Burger Court was more supportive of conservative. He concludes that agency type may not be as important as the directionality of an agency’s decision but the Court appears to be more deferential to the independent commissions over the executive branch regulatory agencies. See Reginald S. Sheehan, "Federal Agencies and the Supreme Court: An Analysis of Litigation Outcomes, 1953-1988," *American Politics Quarterly* 20 (October 1992): 478-500.
policymakers, and penalties for noncompliance. Scholars have also presented conceptualizations of the implementation process such as implementation as evolution, policy environments, policy regimes, policy cultures, and implementing populations. Implementation emerges as a dynamic process involving many varied actors and bound by policy values and institutional arrangements.

The nature of policy subsystems has been debated by students of policy as has the nature of and motivations for congressional oversight of the bureaucracy. These topics cover fundamental issues of the policy process: the role of interested outsiders (in and out of government) in shaping agency policy and the role of the legislative branch in supervising and interacting with the bureaucracy. The principal-agent framework has yielded some good results and is one approach for analyzing the bureaucracy's relationship with other actors. Judicial interaction with agencies is the main topic of interest here and the literature contains some important ways of viewing that relationship.

Of major concern, the work surveyed in this chapter provides a basis for answering the two questions posed at the beginning and for designing the variables used in the present research. Many significant issues are raised in the various studies presenting the challenge of insuring that the present effort remains manageable. It is important in this research to consider the basic factors important in implementation (particularly the implementation of court orders) and the context of that process.

The considerations that the literature suggests as important in attempting to answer the guiding questions of this research include first the dispositions of officials and the commitment of the agency to what it is implementing. The agency's enthusiasm or lack thereof for the policy and the court order is crucial. A second consideration is the implementation context, the agency and its environment. As shown by various

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authors, that context can be broad including the various populations affected by a court order or policy. Subsystems and coalitions are major points of interest, the agency and outsiders such as Congress and interest groups. Also important here would be the policy atmosphere or culture, beliefs about policy in an area at a particular time. For example, the Reagan administration thrust toward deregulation would be important in studying natural gas regulation during those years. In addition, the questions of how policy is moving or evolving in an area and the role that the courts and litigation play in that movement need to be studied.

The literature also suggests the need to pay attention to policy context in other more general but still overlapping ways. The ongoing state or nature of a policy subsystem is important. Is the subsystem more like a subgovernment or an issue network? Are relationships stable or changing? Are factions able to work together? Congressional oversight or domination of the agency needs to be considered. How does the legislative branch influence policy here? Does it? Is fire alarm oversight used? The roles of other principals, mainly the White House, cannot be ignored. And finally, of course, the nature of the interaction between the court and the agency has to be examined. As touched on already here, the role of the judiciary in the policy area through the implementation of the specific court orders is a significant issue.

**Research Design**

This part of the discussion builds on the observations in the relevant literature to construct five major independent variables for use in this study. After that description, various research design issues such as operationalization of both independent and dependent variables and indicators to be used plus potential objections to the research are covered.
The Variables, Hypotheses, and Guiding Logic

The literature suggests the importance of five major variables in explaining agency implementation of a disruptive court order: agency commitment to the existing program, the disruptiveness of the court order, the likelihood and severity of penalties for noncompliance with the court order, agency views of the court issuing the opinion, and external pressures on the agency.

Building upon the observations of the implementation and bureaucratic literature (including Van Meter-Van Horn, Sabatier-Mazmanian, Johnson and Downs) reviewed above, it is reasonable to say that an agency’s commitment to its existing program should lead it to resist or evade the court order striking down that program, particularly if it had been enthusiastically implementing the policy (favorably disposed toward it), and saw the program as part of the agency’s mission (i.e., a means of achieving the good society). Less enthusiastic support for the program within the agency may lead to more faithful implementation of the court order. As part of the policy evolution described by Majone and Wildavsky, commitment may increase or decline. And it should reflect the values or policy culture, such as deregulation and favoring market forces in the case of natural gas, that are prevalent at the time. The amount of support for the program within the agency should help to determine how disruptive the court order is for the agency and thus how willing it will be to change in response to the order.

Disruptiveness of the court order refers to how much the order actually affects the program. If an order is more disruptive (i.e., if it has more profound impact on the program), the agency may try to resist it more forcefully or be more likely to undertake the search process.
described by Johnson to find alternatives to faithful implementation. An order that is less disruptive may be more easily implemented.

Likelihood and severity of penalties for noncompliance with the court order also follows directly from the literature, particularly Johnson's and Brown and Stover's studies. Agency perceptions of sanctions for not complying may lead to more faithful implementation (or at least less evasion) of the court order. The agency must perceive, however, that the possible sanctions, such as the threat of additional litigation being initiated by the opposing litigants (the potential penalty being considered in this research), are to be avoided in order for those sanctions to have any force or impact on behavior. The agency's evaluation of the potential sanctions for noncompliance may include a determination of whether it is being watched by the opposing litigants as it responds to the court order, thus increasing the chances of further litigation. The literature on subsystems and adversarial coalitions reviewed above (such as Berry and Gormley) would seem to suggest that the chances of continuing litigation and judicial intervention would be great in some policy areas (including regulation and natural gas).106

The fourth independent variable, agency views of the court, builds upon Fiorino's and Melnick's and Goggin's observations, although in a somewhat different manner. The factors to be considered here are whether the agency views the court generally as friend or foe, as an important ally or as a tool of its opponents. The agency's evaluation of its relationship with the court may lead it to view the court's opinions

106 Another potential sanction, contempt citations, was dropped after being initially considered. The research did not yield any indication that contempt citations were used (at least not to any great degree) in the five cases studied. Rebukes in subsequent orders were used by the judges, however. It should also be noted that it is not clear to what extent the FERC views litigation as a penalty given its frequency although some at the Commission do not want the agency to be reversed in court.
with more or less legitimacy. According less legitimacy to an opinion should lead an agency to more willingness to evade that order. The agency’s past interactions with the court and its views on how the court views it (the agency) are important factors here.¹⁰⁷

The fifth independent variable, external pressures on the agency, includes outsider influence on agency decisions. Such influence may be in the form of agency involvement in subsystems, outsider formation of coalitions (possibly including agency officials) to influence the agency, and legislative and executive oversight (formal, informal, the McCubbins-Schwartz fire alarms, the latent oversight described by Ogul-Rockman). The agency may also go to outsiders willingly for advice on what to do in response to the court order or it may try to resist the influence of outsiders and make its own decisions. Another factor to be considered is whether a generally good view of the opposing litigants led agency officials to consult with them when implementing the court order.¹⁰⁸

¹⁰⁷ During the course of this research, an additional possibility was found. The agency might also accord legitimacy to the court and thus feel compelled to obey merely because it is the court, regardless of the ongoing relationship. This is more in line with Shapiro’s view that the statute maker has established its judicial subordinate as overseer of its administrative subordinate. The courts thwart any agency attempts to subvert legislative intent.

¹⁰⁸ Other themes brought out in the literature reviewed above provide a basis for this variable. These include the kaleidoscopic nature of coalitions (interests coming and going) characterizing the implementation of regulatory policy described by Ripley and Franklin, the notion of multiple principals to be attended to by the single agent as discussed by Moe and Wood, dominance of the agency by the legislative, and the various pressures and institutional arrangements mentioned in the implementation literature such as Stoker’s policy regimes and the different populations described by Johnson and Canon.
The hypotheses guiding this research are set forth below. They are:

*Higher commitment should lead to less faithful implementation of the court order. Lower commitment should lead to more faithful implementation.*\(^{109}\)

*Greater disruptiveness should lead to more evasion of or attempts to limit the court order. Lesser disruptiveness should lead to more faithful implementation.*

*Greater likelihood and severity of penalties for non-compliance (i.e. more litigation) should lead to more faithful implementation. Less likelihood and severity of penalties for noncompliance should lead to less faithful implementation.*

*A positive agency view of the court should lead to more faithful implementation of the court's order. A negative agency view of the court should lead to less faithful implementation of the court's order.*

*Greater external pressure in support of the court order should lead to more faithful implementation of that order. Greater external pressure in opposition to the court order should lead to less faithful implementation of the order.*

The underlying logic of these five variables should be discussed. Recalling the two basic questions of the research, how does the agency respond to the court order and what is the role of influential outsiders in framing the response, the attempt has been made to include a mix of internal and external factors important in implementation generally and court orders specifically. It is felt that the variables selected capture the diversity of factors crucial to answering these two questions. All major

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\(^{109}\) One complicating factor here is that as noted above the Commission viewed the courts as legitimate authorities to be obeyed. Thus, despite high commitment there might also be faithful implementation of the court order.
actors are covered. The major internal actor is the agency itself and its motivations. As noted by Meier, the regulatory agency is not a passive actor but is pursuing its own goals although constrained by the actors in its environment. The major external actors are Congress and interest groups and to a lesser extent the White House. Selected judicial-related factors that are suggested by the literature, view of the court and penalties for noncompliance, are also included.

In addition, the dynamics of the policy process, its sloppiness more than a success/failure dichotomy, needed to be shown. The evolution/redesign facet of implementation models was a related and important factor and the research seeks to include it by examining how litigation affects the evolution of policy. In a conflictual area such as natural gas regulation, policy evolves in a subsystem context (advocacy coalitions more than subgovernments) and litigation is an important tool used by participants in that process. The frequent use of litigation allows the courts an opportunity to shape policy here. All of these facets, the various actors and their goals and the aforementioned dynamics of this process, are hopefully incorporated in the model and its variables.

The dependent variable, agency response to the court, is concerned with the question of whether the agency implemented or evaded the court order. Variations in the implementation-evasion continuum are noted in each case. A continuum of responses can be used with implementation and evasion at the extremes. The variable is seen as a single dimension although the agency could be at different points of the dimension (i.e.

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Likelihood and severity of penalties is a variable mainly dealing with the agency's perceptions of what outsiders will do (i.e. initiate litigation). As such, it represents a type of external pressure on the agency. However it is considered separately in this analysis to highlight a specific type of pressure, one that is judicially-related, and to shed further light on the impact of litigation on agency behavior.
pursuing seemingly contradictory courses of action) at the same time. For example, the agency could begin to implement an adverse order while also appealing to a higher court to have the order overturned.\footnote{In addition to implementation-evasion, another possible comparison that was initially considered was intended response vs. official response. This comparison would have been useful because it would have shed some light on whether the agency implemented the court's order grudgingly or willingly, but it had to be dropped from the analysis. The research showed that the official response of the Commission, its final order in a case, was for all intent and purposes its intended response.}

The independent variables could have some effects on each other above and beyond the impact that they have on the dependent variable. Four such effects or interrelationships seem to be important and worth considering in the analysis. These are treated as lesser hypotheses, supplemental to those stated above that guide the study and they are commented on in Chapter 4 as the data permit.

The first is that \textit{external pressure can affect agency commitment to program at different stages of the rulemaking process}. External pressure on the agency is without question a very significant variable in terms of its potential effects on agency commitment to the program. Outsiders may have been influential in the program's formation, especially if they are an important part of the constituency of the agency.\footnote{It should be noted that these potential effects of external pressures assume the broader, looser definition of subsystem. As Ripley and Franklin observed, a subgovernment will probably not be able to function here.} Group comments in rulemaking proceedings could reinforce or lessen commitment although the Commissioners would have to be open to such persuasion. Another possibility is that group initiation of litigation might lessen commitment to the targeted program or policy. This effect would probably be somewhat rare, however, because litigation is so
common in natural gas regulation. Congressional pressures in the form of hearings, letters, and floor actions directed at specific FERC policies might also have some effects on commitment.113

The second minor hypothesis states that agency commitment to the program will override disruptiveness of the order and likelihood and severity of penalties as a force in agency response to the court. Commitment to the program under attack should lead the agency to attempt evasion from the order. The disruptiveness of the order will also be important in the agency's decision to search for alternatives to faithful compliance, although this variable's effects may be tied at least partly to the commitment to the program on the part of the agency.114 An order gutting a program that an agency may not have liked in the first place probably will not be considered overly disruptive. Likelihood of stiff penalties for evasion may force the agency to

113 Of course, external pressures can also have the hypothesized direct effects on agency response to the court. Comments in rulemakings, initiated to respond to a court order, could be filed by groups, members of Congress or the administration. These might be expected to have some effect as the Commission fashions its response (again dependent upon the Commission's willingness to listen). Congressional action in the forms noted above could also be directed at the Commission's response.

Isolating and analyzing these various effects of external pressures is a major challenge of the research. The attempt is made in the analysis to separate the components of this variable and to consider the types of influence. The chronology of a case is important in this endeavor. For example, if the FERC after significant opposition substantially modifies a rule responding to a court order, external pressure could be said to have had some influence on agency response directly. On the other hand, if the FERC was moving away from a program at the instigation of outsiders external pressure would be influencing commitment which would then be reflected in agency response to the court.

114 The relationship between commitment and disruptiveness presents a similar analytical problem as that between external pressure and commitment. Here also, care will be taken to try to sort out these effects.
implement the order more faithfully, but the agency will move only reluctantly and even then may still not comply entirely. In addition, the agency's officials may decide that the potential sanctions, even if likely to be applied, are still worth bearing in order to salvage the program as much as possible.

A third hypothesis is that agency views of the court issuing the disruptive order are expected to play some role, but generally not as important a role as commitment to the program. Views of the court may simply reinforce internal decisions already made on whether to implement or evade the order, based on the commitment to the program and the likelihood of penalties being applied for noncompliance. However, (as found in this research) agency acceptance of judicial legitimacy could at times override commitment so that view of the court cannot be dismissed as minor in all instances.

The fourth hypothesis is: greater agency commitment should result in less of a role for the external pressures in determining agency response to the court. It would seem likely that the internal variables, particularly agency commitment to the program, would be the most influential, especially if the agency is united internally on what it should be doing. External pressures from congressional, executive branch, and interest group sources cannot be taken too lightly by the agency, however. Officials may have a stake in established relationships and working arrangements with those outsiders. Such established arrangements plus the formal authority of legislative and executive sovereigns and the substantial resources of interest groups represent significant constraints on agency actions. Splits within the agency over the wisdom of the program struck down in court could accentuate the influence of the outsiders. However, if the agency is deeply committed to the program, with minimal splits among its personnel, it is expected that
external pressures will play less of a role in shaping the agency response to the court.\textsuperscript{115}

**Research Design Issues**

The operationalization of the variables, the indicators used for the independent and dependent variables, and sources of data are all major concerns. Serious questions can also be raised about the design and execution of this type of inquiry. These issues are considered below beginning with operationalization and objections.

Operationalization of the variables is unquestionably an important issue here. The approach employed in this research is a qualitative factual analysis. The overriding criterion is one of the "weight of the evidence," using facts and information obtained from the several sources described below and trying to determine what those sources have to say in answering the research questions. Disagreements among the sources will be noted.\textsuperscript{116}

\textsuperscript{115} In short, high commitment to the program should lead to a moderate or lesser role for the other independent variables as the agency attempts to save its policy. Lower commitment to the program should allow the other independent variables to play a more substantial role in fashioning the agency's response to the court order. The reviewed literature appears to fall on both sides of the question of internal v. external influence. On the one hand, the studies by Moe of the NLRB and other regulatory agencies found some significant external, especially presidential, influence. On the other hand, the studies by Krause of the Federal Reserve and Eisner and Meier of the Department of Justice point up the importance of internal factors.

\textsuperscript{116} Within each case study in Chapter 4, the attempt is made to assess the relative importance of each independent variable as it impacts on the dependent variable. An assessment of the positive and negative effects of the independent variables on the dependent variable is undertaken in the cross-case analysis at the end of that chapter.
Admittedly, one cannot entirely avoid the criticism that this research employs a "know it when I see it" standard. For example, is agency commitment in the eyes of the beholder? As shown in chapters 3 and 4, the Commission appeared committed to one of its programs, special marketing programs, but had actually begun to move beyond them and quickly abandoned them when they were overturned in court. Disruptiveness of an order is being evaluated after the fact here as compared with its perception at the time.

The all-important questions of reliability (do repeated measurements of the same phenomenon yield very similar results?) and validity (does the measure actually tap into and measure the concept?) as discussed by Bowen and Weisberg come into play. It is felt that sufficient care is being taken to insure that those concerns are addressed to the extent possible given the limitations of the current effort (for example, by noting the disagreements in the data and by examining more than one case). As Bowen and Weisberg observe, social scientists are concerned essentially with explanation of people's behavior and attitudes. They state further that the process proceeds by disproving alternative hypotheses rather than gathering evidence to support a hypothesis.117

The author believes that this research does shed light on and helps to explain the process of agency response to court orders in a subsystem context. Purists might ask where the science is. The science has to be found here more in the approach used (the specification of the variables and hypotheses to be tested, the use of various indicators and multiple data sources, and the attempt to explain), in the guiding theory of the

117 See the discussion in Bruce D. Bowen and Herbert F. Weisberg, _An Introduction to Data Analysis_ (San Francisco: W. H. Freeman and Company, 1980), pp. 11-12, 18-19.
research, and in the grounding of this study in the findings of previous studies than in any set of quantitative indicators.

Table 1.1 below contains an overview of the various indicators and data sources used in the analysis. Indicators for the independent variables are covered first. For agency commitment, the presence of a longstanding or well-developed policy and/or multiple orders reaffirming a policy are key. It is possible that an agency might continue to affirm or flesh out a policy to which it is only marginally committed especially if said program has been forced upon it by the Congress or White House. That limitation should be minor as bureaucracy is notorious for seeking to maintain its turf and a longstanding policy would be part of that. An agency might be committed to the continued operation of a program that it is not very enthusiastic about especially if the policy is under attack from outsiders.

The indicator for external pressure perhaps seems self-evident. In a rather contentious regulatory policy subsystem, there will always be attempts by outside parties to influence the FERC. As shown in the case studies, however, there are differences in the levels of pressure depending on the issue involved. Some cases involved many outside parties while others involved few. The presence of any attempts to influence or coerce the FERC will be a good sign of that external input even if not quantified as to relative impact.

For agency view of the court, important signs are actions or statements by the FERC generally reflecting unfavorable or favorable views
<table>
<thead>
<tr>
<th>Variable</th>
<th>Indicators</th>
<th>Data Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Variables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agency Commitment to Program</td>
<td>Presence of long-standing or well-developed policy</td>
<td>Agency orders; Statements made at hearings, FERC meetings, or other public forum; Interviews</td>
</tr>
<tr>
<td></td>
<td>Multiple orders reinforcing or reaffirming policy</td>
<td></td>
</tr>
<tr>
<td>External Pressure</td>
<td>Presence of any attempts by outside parties to exert pressure or to influence the FERC</td>
<td>Statements made at hearings or in rulemakings; Public statements recorded in trade press; Letters; Interview data</td>
</tr>
<tr>
<td>Agency View of the Court</td>
<td>Actions indicating favorable or unfavorable view or legitimacy</td>
<td>Agency orders; Statements made in FERC mtgs. or other statements recorded in trade press; Interview data</td>
</tr>
</tbody>
</table>

To be continued

Table 1.1: Indicators and data sources for the independent and the dependent variables.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Indicators</th>
<th>Data Sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Variables (Continued)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Likelihood &amp; Severity of Penalties for Noncompliance</td>
<td>Any felt need to obey court in order to avoid further litigation</td>
<td>Agency orders; Statements made in FERC mtgs. or other statements recorded in trade press; Interview data</td>
</tr>
<tr>
<td>Disruptiveness of the Court Order</td>
<td>Any indication that the order will disturb agency procedures or subsystem operations</td>
<td>Agency orders; Statements made in FERC mtgs. or other statements recorded in trade press; Interview data</td>
</tr>
<tr>
<td>Dependent Variable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agency Response to the Court</td>
<td>Actions taken, statements made by the FERC in response to the court rulings in a case</td>
<td>Agency orders; Statements made in FERC mtgs., Congressional hearings, or other statements recorded in trade press; Interview data</td>
</tr>
</tbody>
</table>
or the Commission’s view of the judiciary initially as friend or foe but then primarily as a legitimate authority to be obeyed. Findings of this research resulted in a modification of the variable and indicator to include the legitimacy component and this addition resulted in greater impact in the cases for this variable.

Any attempts by the FERC to avoid further litigation or court defeats are significant to penalties for noncompliance. An agency would certainly want to avoid blows to its prestige or good standing with the court and would thus feel the need to obey the court. However the constant use of litigation in the subsystem might make the penalties routine, removing some of their sting.

Disruptiveness of the court order has been redefined also, due to research findings on the impact of certain orders on the natural gas industry, to include disruption of subsystem operations. This expansion of the variable and its indicator is in accord with the literature on subsystems and as with agency view of the court results in a larger more important role for the variable in certain of the cases.

As shown in the table the indicator for the dependent variable, agency response to the court, consists of actions taken or statements made by the FERC in response to the court rulings in a case. The major official responses to each of the court orders are covered in the analysis. As mentioned above, the notion of intended versus official response was explored but had to be dropped.

Several major data sources, shown for each variable in Table 1.1, are used in the research. For all of the variables, independent and dependent with the exception of external pressure, a basic source for sketching out the chronology of each case, the official actions, and reasons for those actions consists of the Commission orders as published in the *Federal Register* and the FERC reporter. Many of the variables are concerned with FERC perceptions and concerns about policy and the
court orders. The official FERC orders and policy statements as well as the rulemaking notices, inquiries, and proposals leading up to the final orders (also published in the *Federal Register*) are valuable sources for gaining insight into how the Commission is thinking and what is doing. Commission orders are of some, although lesser, use in studying external pressure mainly through the FERC responses to outsider arguments in rulemakings.

A second major source useful for studying all of the variables is the trade press. Fortunately for this effort, McGraw-Hill publishes *Inside F.E.R.C.*, a weekly newsletter and perhaps the main publication dedicated exclusively to the Commission. The issues of this publication were examined directly or through LEXIS/NEXIS keyword search for every year of the Reagan administration. The newsletter included accounts of Commission meetings, Congressional hearings, trade association meetings, and other public forums at which Commissioners and other parties would be speaking. These accounts were very useful for discovering what the Commissioners were thinking as they debated the orders that were the target of litigation and that responded to the court. They were also important sources of information for gauging external pressure on the FERC by describing interest group statements, lobbying efforts, and litigation.

The third major data source used was interviews with some of the important actors in federal natural gas policymaking during the Reagan era. Approximately thirty-five interviews were conducted in person and over the telephone with current and former FERC Commissioners and officials, congressional staff, interest group representatives, and Office of Management and Budget officials. In-person interviews were tape recorded while notes were taken during telephone interviews. Many different voices were heard from in the interviews including several commissioners, senior FERC office staff, commissioner aides, staff from
both House and Senate authorization and appropriations committees, the White House (in the form of OMB), and all major segments of the natural gas industry. This was a crucial source of information on all of the variables and provided insight into the operations of the gas policy subsystem.

A fourth major data source consisted of miscellaneous documents. These included congressional hearings which were important for studying external pressure and for viewing FERC relations with an important outsider. Other documents useful for examining Commission interaction with Congress were letters to the Commission from members of Congress obtained mainly from the FERC public reference office. The Commission's official newsletter, the Monitor, was published for several years during the Reagan administration and proved to be a valuable source on the workings of the FERC, pending cases before the FERC and courts, and natural gas regulatory issues.

Naturally many of the above data sources will show public posturing so the major challenge is to find what lies behind such behavior. The trade press should be helpful in reporting motivations and views. Guarantees of anonymity in the interviews should hopefully have resulted in greater candor and truthfulness. Where possible, the effort will be made to confirm points with more than one data source while conflicts will also be noted. Differing viewpoints will be noted as they show the workings of the subsystem.

The Organization of the Study

Having now summarized some of the major literature on implementation generally and implementation of court orders in particular, and having specified the variables for the study, the next major task is to
provide some background on natural gas regulation at the federal level. This is done in the next chapter.

Chapter 3 contains a chronological summary of the five court cases, leading into a discussion, in chapter 4, of the influence of the five independent variables on the dependent variable within each case and across cases. Chapter 5 provides some concluding thoughts on the implications of the findings of this study for other areas of research.
CHAPTER 2

OVERVIEW OF FEDERAL NATURAL GAS REGULATION

This chapter contains background material intended to help the reader understand better the case studies and analysis presented in subsequent chapters. The material includes overviews of the relevant portions of the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978, a description of the Federal Energy Regulatory Commission (FERC) and its responsibilities under those statutes, and a discussion of important factors in the Commission’s environment including the White House, Congress, interest groups, and the courts.

The Natural Gas Act

The Natural Gas Act (NGA) was enacted in 1938 as a response to a variety of problems and ills that were seen in the gas industry in the 1930s. Many of these problems arose from domination of the industry by large holding companies. State regulation could not effectively oversee multistate companies. In 1935, Congress enacted legislation to break up the holding company systems. In 1938, the Natural Gas Act was passed to provide utility regulation by the Federal Power Commission (FPC), the
predecessor of the FERC, for the interstate pipelines.\(^1\) As section 1(a) of the NGA stated,

> it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.\(^2\)

For the purposes of this study, sections 4, 5, and 7 of the Act are the most important and this discussion is limited to those sections.\(^3\)

Section 4 deals with the rates for the transportation or sale of natural gas subject to Commission jurisdiction, specifying that such rates must be just and reasonable. Unjust and unreasonable rates were declared unlawful. Undue preferences or advantages (as well as undue prejudices or disadvantages) and unreasonable differences in rates were prohibited by the Act.

Natural gas companies were to file changes in rates with the Commission thirty days before such changes were scheduled to take effect. The Commission could decide to hold hearings on the proposed rates and suspend their operation for up to five months from the time that they would have gone into effect. If the proceeding had not been concluded at the end of the five months, the natural gas company could

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begin collecting the new rate. The Commission could, however, subse-
sequently order the company to refund with interest any part of the charges
that it had not found to be justified. Whenever a company sought an
increase in rates, it had the burden of proof to show that the increase was
just and reasonable.

Section 5 of the NGA empowered the Commission to determine
and set a just and reasonable rate for a company when it found, after a
proceeding initiated by the Commission itself, that the company’s current
rate was unjust or discriminatory. The Commission could begin the
proceeding on its own initiative or after receiving complaints from a
state, city, state utility commission, or a local distributor. Section 5
mandated that the regulators could not order an increase in rates unless
such an increase was already included in a new rate schedule filed by the
company with the Commission. The Commission could, however, order
decreases in rates.

The Commission was also authorized to investigate, on its own
initiative or at the request of a state commission, and determine the cost
of a natural gas company’s gas production and transportation operations.
The Commission could take such action in cases even when it did not
have the authority to set rates for those operations.

Section 7 authorized the Commission, if it found such action to be
in the public interest, to order a natural gas company to extend or im-
prove its transportation facilities and to connect with and sell gas to a
local distribution company or a municipality selling gas to the public.
The Commission would have to hold a hearing and conclude that no
undue burden would be placed on the company and that service to the
company’s current customers would not be harmed.

Abandonment of service subject to the Commission’s jurisdiction by
a natural gas company was prohibited under section 7 unless the company
first obtained the Commission’s approval. The Commission was required
to hold a hearing and find that the supply of gas was depleted such that continued service was not justified or that abandonment was permitted by the present or future public convenience and necessity.

A natural gas company could not undertake service subject to the Commission's jurisdiction unless it first obtained from the Commission a certificate of public convenience and necessity. This requirement, section 7(c), applied to the transportation or sale of natural gas, or the construction, extension, acquisition, and operation of facilities. Certificates would be issued after the Commission held a hearing on the application. The Commission could, however, issue a temporary emergency certificate to assure continued service to a particular customer.

Section 7(e) stated that the Commission would issue the certificate of public convenience and necessity if the regulators found that the applicant was able and willing to do what it said it would do in the application. The Commission also had to conclude that the applicant was willing to conform to the provisions of the NGA and resulting Commission regulations, and that the proposed service was or would be required by the present or future public convenience or necessity. The Commission also was given the power to attach to the certificate that it issued "such reasonable terms and conditions as the public convenience and necessity may require."^4

From the passage of the Natural Gas Act in 1938 until the mid-1950s, the Federal Power Commission interpreted "natural-gas company" to mean interstate pipelines. Section 1(b) of the law had exempted the production or gathering of natural gas from federal jurisdiction. The

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FPC had claimed some jurisdiction to set rates for producers affiliated with interstate pipelines, but not for independent producers.⁵

In 1954, however, the U.S. Supreme Court overruled a Commission decision and stated that Congress intended the FPC to regulate the rates of all wholesale sales of gas in interstate commerce, regardless of whether or not those sales were made by an interstate pipeline. Thus, independent producers’ sales in interstate commerce were placed under FPC authority.⁶

In the following two and one half decades, the Commission used a variety of rate setting approaches in regulating the producers. First, the FPC tried to calculate a fair return for each producer through traditional utility rate of return regulation. The Commission shifted in the 1960s to an area rate system in which rates were set for each of twenty-three gas producing regions. And finally in the 1970s, the FPC set a national rate.

FPC regulation kept the interstate market's gas prices lower than the prices found in the unregulated (by the FPC) intrastate markets. Thus, the intrastate market was more attractive to the gas producers. Production declined because the low prices being offered in the interstate market did not cover the costs of drilling. At the same time, demand was increasing especially in the interstate market.

This combination of factors, low interstate prices, the attractiveness of the intrastate market, declining production, and increasing demand, resulted in severe shortages in the interstate market in the late

⁵ See Sanders, Regulation of Natural Gas, pp. 82-84; and Kevin A. Kelly et al., State Regulatory Options for Dealing with Natural Gas Wellhead Price Deregulation, NRRI 83-7 (Columbus, OH: National Regulatory Research Institute, 1983), pp. 307-309.

1970s, especially in the winter of 1976-77. The shortages prompted Congress to pass new major legislation in 1978.\textsuperscript{7}

### The Natural Gas Policy Act of 1978

The Natural Gas Policy Act of 1978 (NGPA) was a compromise between those who sought to deregulate gas and those who wanted continued regulation. The Act provided for deregulation of "new gas" while continuing the regulation of the price of "old gas." It also provided for price increases to spur production and for regulation of intrastate prices. Title I on wellhead pricing is the most important for the concerns of this study.\textsuperscript{8}

Section 101 describes the annual inflation adjustment factor to be used for the mandated price increases. The general rule was that the factor applicable to any one month would be equal to the sum of one hundredth of the quarterly percent change in the Gross National Product implicit price deflator, as computed and published by the Department of Commerce, and a correction factor of 1.002.\textsuperscript{9}

Sections 102 and 103 covered new gas.\textsuperscript{10} "New natural gas" was defined in section 102 as gas produced from new Outer Continental Shelf leases or from a new onshore well which was 2.5 miles or more from the nearest existing well or which was at least 1,000 feet deeper than any existing well within 2.5 miles of it. An Outer Continental Shelf reservoir

\textsuperscript{7} Kelly, \textit{State Regulatory Options}, pp. 311-317.


must not have been discovered before July 27, 1976 in order to qualify for
the new gas prices. Drilling for a new onshore well was to have begun on
or after February 19, 1977 according to section 102. Gas produced from
a reservoir onshore that had not been producing in commercial quantities
before April 20, 1977 was also classified in section 102 as new gas.

The maximum lawful price for section 102 gas was to be $1.75 per
million British Thermal Units (Btu) in April 1977. In ensuing months up
through April 20, 1981, the maximum lawful price per million Btu’s was
to be calculated by multiplying the previous month’s maximum lawful
price by the monthly equivalent of a factor equal to the sum of the annual
inflation adjustment factor applicable to that month and .035. After
April 20, 1981, the figure of .035 was increased slightly to .04.¹¹

Section 103 covered gas produced from new onshore wells. A "new,
onshore production well" was defined as one for which drilling began on
or after February 19, 1977; one which satisfied applicable federal or state
well spacing requirements; and one which was not within a proration unit

¹¹ The Conference Committee report on the NGPA gave the following example.

The ceiling price for new gas is initially set at $1.75 as
of April 20, 1977. The first price adjustment to be applied to
that $1.75 price occurs on May 1, 1977. The quarterly per­
cent change in the GNP implicit price deflator for the second
quarter of 1977, expressed as an annual rate is 7.7, which,
when divided by 100 and added to 1.002 yields an annual
inflation adjustment factor of 1.079. The growth factor of
.035 is added to this to yield an annual escalation rate of
1.114 the twelfth root of which is 1.00904. The price for
April 20, 1977 ($1.75) is multiplied by this monthly price
adjustment factor of 1.00904 to yield a maximum price of
$1.766 applicable to all deliveries made during May, 1977.

See U.S., Congress, House, Natural Gas, Conference Report, H.R.
Rept. No. 95-1752 to Accompany H.R. 5289, 95th Cong., 2d sess., 1978,
pp. 76-77.
(defined as a portion of a reservoir that could be effectively and efficiently drained by a single well as designated by the federal or state agency with jurisdiction over that reservoir) that existed at the time that drilling for the well began.

The maximum lawful price of section 103 gas was to be $1.75 per million Btu's in April 1977. The price was then to be increased in succeeding months from this base by multiplying the previous month's price by the monthly equivalent of the annual inflation adjustment factor applicable to that month.

Section 121 of the NGPA provided for the deregulation, as of January 1, 1985, of prices for all section 102 gas and for section 103 gas that was not dedicated to interstate commerce on April 20, 1977 and produced from a depth of greater than 5,000 feet. Any section 103 new onshore gas not dedicated to interstate commerce on April 20, 1977 and produced from a depth of 5,000 feet or less would continue to have a maximum lawful price set by the FERC although this price control was to be phased out by July 1, 1987.¹²

Sections 104, 105, and 106 covered so-called "old gas."¹³ This was gas already dedicated to interstate commerce when the NGPA was enacted (section 104), gas that was governed by existing intrastate contracts when the NGPA was enacted (section 105), and gas dedicated to interstate commerce or sold in the intrastate market when the NGPA was enacted, the sale of which was covered by a rollover contract (section 106). A rollover contract was defined as a contract entered into on or after the date of the enactment of the NGPA for the first sale of gas previously covered by another contract that expired at the end of a fixed


term and that was in effect at the time that the NGPA was enacted. Old
gas was to remain regulated, with specified monthly increases based on
the annual inflation adjustment factor.\textsuperscript{14}

Section 601 specified that any price paid in a first sale of gas would
be considered just and reasonable for purposes of sections 4 and 5 of the
Natural Gas Act if that amount did not exceed the applicable NGPA
maximum lawful prices. The Commission could then not deny a pipeline
recovery of those costs.\textsuperscript{15}

\textbf{The Federal Energy Regulatory Commission}

The Federal Energy Regulatory Commission (FERC) is the agency
charged with administering the NGA and the NGPA. Established as an
independent regulatory commission within the Department of Energy by
the Department of Energy Organization Act of 1977, the FERC is the
successor agency to the Federal Power Commission (FPC) and inherited
most of the regulatory responsibilities of the FPC as well as oversight of
oil pipelines. That latter regulation had previously been the respon-
sibility of the Interstate Commerce Commission.

The FERC consists of five members who are appointed by the
President and confirmed by the Senate. During the time covered by this
study, the Commissioners served four year terms. The term was extended

\textsuperscript{14} Sections 104 and 106 allowed the Commission to set higher ceiling
prices than those allowed by the NGPA for old gas if the Commission
thought that such prices would be just and reasonable. Section 121 also
specified that gas sold under certain intrastate contracts would be dereg-
ulated on January 1, 1985. This was gas sold under an existing contract
or a rollover contract if such gas was not dedicated to interstate com-
merce when the NGPA was enacted and if the price paid for that gas was
greater than $1.00 per million Btu's on December 31, 1984.

to five years (and member terms staggered) by legislation enacted in 1990. The President designates one commissioner as chairperson and the commissioners themselves select a vice-chair.

The major regulatory responsibilities of the FERC cover natural gas, electricity, oil, and hydroelectric power. During the Reagan administration, the focus of this study, the natural gas regulations included regulating the price of old (NGPA sections 104, 105, and 106) gas already dedicated to interstate or intrastate commerce when the NGPA was enacted, regulating the prices that interstate pipelines may charge for the transmission and sale of gas, approving the construction of interstate pipeline facilities, and approving the commencement or the abandonment of interstate pipeline service. The FERC also may authorize interstate sales by intrastate pipelines under the NGPA. With the exception of the NGPA price regulations, the FERC continues to exercise many of these responsibilities. Congress passed legislation in 1989 phasing out the NGPA price controls by January 1, 1993. The legislation also relieved producers of obligations to file rates and to apply for certification of service under the Natural Gas Act.

With respect to electricity, the FERC regulates wholesale transactions and the transmission of power in interstate commerce. The Commission authorizes the conditions and rates for interconnections among electric utilities, regulates the stock issues and mergers of electric

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utilities, and reviews rates set by the federal power marketing agencies (such as the Bonneville Power Administration).

The FERC also issues permits and licenses to build and operate non-Federal hydroelectric projects. And the Commission regulates the rates of pipelines that transport oil between states.  

The Commission structure consists of a variety of offices with the three main regulatory units being the Office of Electric Power Regulation, the Office of Hydropower Licensing, and the Office of Pipeline and Producer Regulation (OPPR). This last office is the main regulatory subunit for natural gas regulation and thus is the office of most concern for this study.

The Commission has delegated authority to handle routine matters to various office heads, including the Director of the OPPR, "in order to free up the Commission's time to address complex issues...." Delegation covers uncontested matters and involves "only limited decisionmaking" by the office directors. In addition, "as a final safeguard against abuse of authority," these staff decisions can be appealed to the Commission.  

The delegation of authority to the Director of OPPR covers such items as requests for authorization to construct and operate facilities costing less than $5 million dollars, applications to abandon pipeline or producer facilities serving a specific customer if that customer has agreed to the abandonment, applications under the Natural Gas Act to change or 

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19 See U.S., Federal Energy Regulatory Commission, Annual Report 1981 (Washington, DC: U.S. Government Printing Office, 1982), pp. 4-5. In its 1981 annual report, the Commission noted that 14,000 natural gas items (9,000 relating to pipeline certification and 5,000 relating to producer rates and certifications) had been transferred to staff for disposition.
add delivery points for current customers if the amount of gas involved
does not differ from the levels specified in the applicable contracts or
certificates. The Director is also authorized to reject pipeline rate or
tariff filings that do not comply with statutory or FERC requirements, to
take appropriate action on petitions to intervene in uncontested proceed­
ings, to accept for filing data or reports required by FERC orders, to rule
on applications for extensions of deadlines to file reports or information
required by the FERC in its rules or regulations, and to issue reports for
public information provided they are not controversial. 20

The legal office of the FERC is the Office of the General Counsel.
The General Counsel provides a variety of legal services to the Commis­
sion. This office's responsibilities include such areas as legislative
liaison, enforcement (in judicial or FERC proceedings) of the Commis­
sion's enabling statutes, drafting of FERC orders and opinions, and
processing of Freedom of Information Act matters. The Office of the
Solicitor, which is part of the Office of the General Counsel, represents
the FERC in district and appellate court. 21


21 See Gilbert and Geldermann, p. 706.3; see also U.S., Federal
Energy Regulatory Commission, 1985 Annual Report, FERC-0117
239, 244-248. The size of the Commission staff declined somewhat during
the Reagan administration. At the end of fiscal year 1981, the beginning
of Reagan's term, the FERC had 1,602 full-time staff. By the end of
fiscal year 1988 the staff numbered 1,480. See U.S., Federal Energy
The cases covered in this research involve four basic types of FERC procedures: rulemakings, certificate of public convenience and necessity under the Natural Gas Act, abandonment of service, and rates/tariffs. These procedures are covered briefly below. Rulemakings were part of the main focus in most of the cases studied here, including *Mid-Louisiana*, *INGAA* wet/dry rule, and *Maryland People’s Counsel/Associated Gas Distributors*. Both the Natural Gas Act and the Natural Gas Policy Act authorize the FERC to issue any rules necessary to fulfill its responsibilities under those two statutes. The NGPA specifically requires the use of the rulemaking steps mandated by the Administrative Procedure Act. Those procedures, referred to as "informal" or "notice-and-comment" rulemaking, are to be employed by agencies unless they are directed otherwise by their enabling statutes. They were used repeatedly by the FERC in the cases listed above.²²

The rulemaking begins with the agency giving prior notice of its intentions through publication of a notice of proposed rulemaking in the *Federal Register*. The notice must include a reference to the legal authority for the rule and a description of the substance of the proposal. Interested parties must be allowed to participate through the submission of written comments and data. Oral presentations may also be allowed. The agency must then consider the materials presented in adopting the final rule. The rule must include "a concise general statement" on its basis and purpose and is to be published not less than thirty days before its effective date unless the agency has a reasonable justification for another time period. Parties must be given the right to petition an

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agency requesting that a rule be issued, amended or repealed. Figure 2.1 shows the steps of the rulemaking process, including judicial review.

<table>
<thead>
<tr>
<th>NOTICE OF INQUIRY (if issued)</th>
<th>NOTICE OF PROPOSED RULEMAKING</th>
<th>COMMENTS RECEIVED</th>
</tr>
</thead>
<tbody>
<tr>
<td>RULE ISSUED</td>
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Figure 2.1: Steps in the FERC "notice-and-comment" rulemaking process including judicial review.

As described in a previous section, the certificate of public convenience and necessity is granted by the FERC under section 7 of the Natural Gas Act and authorizes the recipient, such as a pipeline, to

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See Administrative Procedure Act, 5 U.S.C. sec. 553(1988). See also Gellhorn and Boyer, pp. 248-250. In its regulations, the Commission has stated that a notice of proposed rulemaking is to be published in the Federal Register no less than fifteen days before the proposal is to be considered for adoption. See 18 CFR sec. 385.1903 (1993).
undertake a new service. These certificates were particularly important in the *Maryland People's Counsel* and *Northern Natural* cases described below in subsequent chapters. Applicants must file a variety of data intended to provide the FERC with a complete understanding of the project and its effect on the applicant's present and future operations. Those data include background information such as the articles of incorporation and bylaws of the company, list of company officials, and a description of any subsidiary or affiliated operations related to natural gas. Annual operating revenues (and related volumes of gas) and expenses must be furnished. The applicant must also describe the proposed service or project including gas fields accessible to the proposed construction that would be able to supply the project adequately and a discussion of the customers to be served by the new project, the cost of the proposal, and plans for financing the project.⁴

If the application meets all of the requirements, it is "accepted for filing" and docketed. A notice that the application has been filed is then published in the *Federal Register*. This notice will specify the time period during which parties can file petitions to intervene in the proceedings. The Commission will then schedule a hearing. The NGA authorizes the FERC to issue the certificate if it finds that the applicant "is able and willing properly" to undertake what it had proposed to do and if it also finds that the project is or will be required by the present or future public convenience and necessity.⁵

Abandonment of service is also covered by the Natural Gas Act and is at the center of the controversy discussed below in the *Consolidated Edison* case. The applicant must describe the reasons for the aban-

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donment and submit various data. Some of the information to be provided by the applicant, such as the background information listed above, is the same as that furnished along with an application for a certificate of public convenience and necessity. There are some special abandonment-related data, however, including a description of other sources of fuel available to the customers whose service is being abandoned, a description of the economic effect of the abandonment on those customers, copies of agreements that influenced the applicant to seek the abandonment, contracts dependent on the approval of the abandonment, and a map of the facilities to be abandoned. The Commission uses the same notice and comment procedure for abandonment applications as it does for certificates of public convenience and necessity. According to the terms of the Natural Gas Act, the FERC must find that the gas supply has been depleted in an area or that the present or future public convenience and necessity will be served before granting the abandonment request.26

Although not the main issue, natural gas rates were a major concern in the Northern Natural case. As noted in a previous part of this discussion, the Natural Gas Act mandates that gas rates are to be "just and reasonable" and prohibits any undue preferences or unreasonable differences. Changes in rates must be filed with the FERC thirty days in advance of the effective date. The Commission may allow the rates to take effect without the thirty day wait or it may also suspend the rate schedule for up to five months after the effective date and hold hearings on the proposed change. At the conclusion of the proceedings, the FERC would then issue an order on the rates. If the proceedings have not been concluded within the five month suspension period, the company may request and be authorized by the FERC to collect the new rate subject to

refund of any amounts not found to be just and reasonable. The burden of proof is on the natural gas company to justify any increase in rates.\textsuperscript{27}

The FERC requires a variety of material to be submitted in rate filings. This includes a statement on the reasons for any proposed rate changes. For major rate increases, those that will result in a general increase in revenues, apply to all or almost all sales or are associated with substantial changes in the volumes of gas delivered to existing customers, data to be submitted by larger companies include overall cost of service (i.e., operation and maintenance, depreciation, and taxes), cost of gas utility plant (including major plant additions and retirements, and cost of various types of plant in service such as production, storage volumes, and transmission plant), working capital (i.e., total revenues, purchased gas costs, salaries and wages, administrative expenses), debt, common and preferred stock, operating revenues and sales volumes, labor costs, an income statement, a balance sheet, and a description of company operations (including a detailed map of the company's system, a rate history, and a description of how the company designs and operates its system).\textsuperscript{28}

Smaller companies must submit less information to justify their major rate increases including an income statement, a balance sheet, description of company operations, and cost determinants for minor changes in rates. This last category is intended to test the reasonableness of proposed rate changes and it includes cost of plant, accumulated depreciation and amortization, working capital, operating and maintenance expenses, taxes, and the cost of service allocated to the sales or service for which the rate increase is requested. For minor rate


increases, applying only to a few rate schedules, and rate decreases, the
data required to be submitted by both large and small companies includes
a balance sheet, an income statement, and the cost determinants for
minor changes in rates.\textsuperscript{29}

A brief procedural discussion of another route to judicial review of
FERC actions would be useful here. As just noted in the description of
certificates of public convenience and necessity, the FERC might hold a
hearing in the course of its consideration. Hearings are not mandatory in
all FERC proceedings but when they are held as in rate or certification
cases, the Commission first issues a notice setting forth the time, place,
and issues involved. Most hearings are presided over by an administra­
tive law judge as in the \textit{Northern Natural} and \textit{Consolidated Edison}
cases although the Commission, one of its members, or a duly chosen
representative of the FERC may also conduct the proceeding. A confer­
ence might be held at any time during the case to discuss issues and the
possibility of settlement. In the hearing, FERC staff and other parties
present evidence and cross-examine witnesses. Parties submit briefs to
the presiding officer who then issues an initial decision and sends the
record to the Commission. The Commission might allow additional oral
argument or briefs before issuing its final order or if no party files an
exception to the initial decision (and the Commission itself does not stay
the initial decision) it may become the final decision. Alternatively, if all
parties to the case so move, the Commission could issue a final order
without first issuing an initial decision. Petitions for rehearing of the
Commission order would be considered and then judicial review would

\textsuperscript{29} Ibid. See also 18 CFR secs. 154.63(a)(3-4), 154.63(b)(4)(1995).
follow final FERC action. Figure 2.2 below shows the main steps of this process including judicial review.\textsuperscript{30}

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Figure 2.2: FERC hearing/adjudicatory process leading to judicial review.

In recent years, the FERC has pursued a policy of trying to make natural gas production, transmission, and distribution more responsive to market forces and less influenced by government regulation. This policy follows at least partly from the decision by Congress in the Natural Gas Policy Act to deregulate the wellhead prices of most natural gas. In fact, a former FERC Chair interviewed for this research remarked that the NGPA deadline of January 1, 1985 for deregulating a substantial portion of natural gas production was the main reason for the Order No. 436 rulemaking, described in the next chapter, that opened up the pipeline system to more competition. It is in sharp contrast to past federal policy, described above, which sought to keep gas prices low for consumers and is blamed by some for stifling incentives for production causing massive shortages in the interstate gas market in the late 1970s.\textsuperscript{31} The Maryland People's Counsel and Consolidated Edison cases, described in the next chapter, involve policies promulgated by the FERC as a part of this market-oriented approach.

Statements taken from some of the Commission's annual reports during the Reagan administration illustrate its approach to gas regulation at this time. The 1985 report includes a description of FERC initiatives (the proposed rule that led to Order No. 436 described more fully in Chapters 3 and 4 below) intended "to allow efficient market principles to operate as much as possible within statutory guidelines." The Commission actions grew out of the Natural Gas Policy Act, passage of which in 1978 had "ushered in a new era" for the gas industry. In its 1986 report the Commission observed that "competition and market forces are replacing the traditional regulatory scheme" as primary motivators for many

\textsuperscript{31} See Raymond J. O'Connor, "Balancing Competition and Regulation in the Natural Gas Industry," Public Utilities Fortnightly, January 24, 1985, pp. 15-17. O'Connor was the FERC Chair from November 1983 to January 1986.
utilities. The Commission and the gas industry had responded to changing conditions (again due to the NGPA and its phased decontrol) with programs designed to "employ competition to protect the public interest as a complement" to traditional regulation. The 1988 report includes a description of the Commission's gas strategy, the purpose of which was "to help resolve regulatory policies at odds with increasingly competitive energy markets." Eliminating "regulatory impediments to competition" was a main goal. Two of the policies described below in Chapters 3 and 4, Order Nos. 436/500 and 490 (abandonment), were parts of this strategy. The Commission noted that the industry had undergone a transition in which the market and not the regulator now dictated prices and services.\textsuperscript{32}

**The Regulatory Environment**

The FERC is subject to potential influence and pressure from a variety of sources both inside and outside government. These would be important parts of the gas policy subsystem and several are discussed below including the White House, the Department of Energy, Congress, interest groups, and the courts.

The White House

The President and the White House have a variety of means at their disposal for influencing any agency. In the case of the FERC and natural gas regulation, some methods proved to be more effective than others. For example, one means by which the administration could try to influence the policy agenda is through legislation. As discussed more fully below in the section on Congress, the legislative option was not a viable one during the Reagan years. The Reagan administration proposed legislation to decontrol entirely the price of natural gas but was unsuccessful.

Another tool for the President to use is the power of appointment, placing individuals on the Commission who shared the administration’s views. The Reagan administration also employed this strategy and it proved to be more effective than legislation in pursuing administration objectives. Favoring the market over regulation as a driving force for industry decisionmaking was a goal of the administration that was pursued forcefully by the FERC especially under Chairs O’Connor and Hesse.33

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33 See, for example, the remark in late 1984 by a special assistant to President Reagan for energy policy that the FERC needed to be more aggressive in revising its regulation of pipelines. There needed to be more emphasis on placing competition in the pipeline industry. See "White House Aide Sees Hard Times for Gas Industry, Changes at FERC," Inside F.E.R.C., November 19, 1984, pp. 8-9.

One long-time staff member from the Office of Pipeline and Producer Regulation, interviewed for this research, noted the shift in emphasis from regulatory control to market forces under the Reagan administration. The shift was profound and seemed to say that the former policies had not worked and "what you did before wasn’t right or wasn’t good and let’s go a new way." The staff member also said that the change was probably for the better from a public policy standpoint (continued...)
Some views expressed by the commissioners at their Senate confirmation hearings (or their written responses to follow-up questions), show the success of the Reagan administration in finding appointees who would carry out a market oriented policy. For example, in responding to follow-up questions, both Martha Hesse and Raymond O'Connor stated their support for the decontrol of natural gas production. Hesse simply noted her support for a Reagan administration bill to deregulate. O'Connor observed that "wellhead prices should never have been subjected to price controls in the first instance." Gas production was a competitive industry and that competition should be permitted and encouraged. O'Connor and Hesse both believed that the removal of price controls would help to guarantee adequate supplies of fuel at proper prices.\textsuperscript{34} Charles Trabandt

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\textsuperscript{34} Commissioner Charles Stalon, an economist and a Democrat appointed by Reagan, also was a major proponent (perhaps the major proponent) of the use of market forces to counteract the monopolistic tendencies of the pipelines. Stalon also supported wellhead deregulation at his confirmation hearing. While decontrol of production was supported by various groups and persons, decontrol of pipelines was not as widely supported. As Stalon observed, many parts of the country were served by only one pipeline. The carriers were thus a natural monopoly in many areas and could not be deregulated. For the views of the various commissioners, see U.S., Congress, Senate, Committee on Energy and Natural Resources, \textit{Boggs and O'Connor Nominations, Hearing before the Committee on Energy and Natural Resources.} 98th Cong., 1st sess., 1983, pp. 101-102; U.S., Congress, Senate, Committee on Energy and Natural Resources, \textit{Hesse and Wampler Nominations, Hearing before the Committee on Energy and Natural Resources.} 98th Cong., 2d sess., 1984, pp. 22, 88. (continued...)
argued that energy policy in general should "be based on maximum responsible reliance on the free market, supplemented by Federal programs as necessary to ensure the energy security and economic well-being of the Nation."\(^{35}\)

Testifying before the Subcommittee on Energy and Water Development of the House Committee on Appropriations on behalf of the Commission's 1983 budget proposal, FERC Chair C. M. Butler III, who preceded O'Connor, also expressed support for decontrol of natural gas. Butler's remarks were interesting for what they said about the relationship of the Commission and the Reagan administration at that point (March 1982). He stated that the administration had been "extremely careful in recognizing the independence" of the FERC. Thus Butler had not participated in the discussions within the administration over any decontrol legislation to propose to Congress. Butler stated that he had

\(^{34}\)(...continued)

In her confirmation hearing for a full term in 1987, Hesse remarked that the FERC had been trying to establish generic regulatory policies to enhance the role of competition in energy markets. In instances where the Commission had to regulate because market forces could not be depended on, the FERC had tried to "simulate competitive outcomes." See U.S., Congress, Senate, Committee on Energy and Natural Resources, Martha O. Hesse Nomination, Hearing before the Committee on Energy and Natural Resources. 100th Cong., 1st sess., 1987, p. 6.

\(^{35}\) See U.S., Congress, Senate, Committee on Energy and Natural Resources, Miller, Horn, and Trabandt Nominations, Hearings before the Committee on Energy and Natural Resources. 99th Cong., 1st sess., 1985, p. 113. In addition, Commissioner Sousa testifying as Acting Chair before the House Subcommittee on Energy and Water Development on the Commission's 1987 budget proposal stated his support for decontrol. He also felt that most of the other commissioners would agree. See U.S., Congress, House, Committee on Appropriations, Energy and Water Development Appropriations for 1987, Hearings before a Subcommittee of the Committee on Appropriations, Part 6. 99th Cong., 2d sess., 1986, p. 31.
been "lobbying" the White House to take action on gas decontrol "virtually from the time that I came into office." He had written the first draft of the 1980 Republican platform on energy and felt that the roles were being reversed as he was the one pressing for action by the administration instead of the other way around.\(^\text{36}\)

In addition to shaping the FERC through appointments, another possible means of White House influence or control of the Commission is the budget process. However, two officials with the Office of Management and Budget (OMB) said in interviews that there were no major attempts by the White House to influence the FERC through their

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\(^{36}\) See U.S., Congress, House, Committee on Appropriations, *Energy and Water Development Appropriations for 1983, Hearings before a Subcommittee of the Committee on Appropriations, Part 5.* 97th Cong., 2d sess., 1982, pp. 349, 356. For another example of Butler speaking out for decontrol of gas, see "What the Commissioners are Saying," *FERC Monitor*, October 19, 1981, p. 9 reporting on a speech in which Butler told the American Gas Association that decontrol was needed to avoid political and economic chaos. For other Butler comments on the need for decontrol, see "What the Commissioners are Saying," *FERC Monitor*, January 25, 1982, p. 14 and "Butler Calls for Immediate Decontrol; Cap on Take or Pay Clauses," *FERC Monitor*, October 4, 1982, p. 16.

In an interview with *Inside F.E.R.C.*, after he had been nominated for Chair of the FERC, Butler remarked that he had not received any instructions from the Reagan administration on how the FERC should regulate the energy industries. See "Inside F.E.R.C. Interview: Butler Sees Conflict in FERC-DOE Connection; Leans Toward Severance," *Inside F.E.R.C.*, April 13, 1981, pp. 1, 6. Similarly, a member of the FERC during the Reagan administration stated in an interview for this research that he received no communications from the White House once he joined the FERC. In his opinion, the White House and the Department of Energy did not really know what the FERC was doing. This would perhaps indicate that the President appoints the Commission but does not lobby it.
office. One official noted that the Office was careful to respect the integrity of the Commission in order to avoid creating any problems. The other official stated that the Office did not have the review authority over the Commission that it had over nonindependent agencies. The OMB did try to become familiar with an agency by discussing issues with agency staff and the Office may have some influence through those contacts. For example, in discussing the Commission's budget, policy objectives would also be covered and the OMB was in a position to encourage the FERC in its pursuit of market-oriented policies. The Office reflected the

37 Unless another source, published or nonpublished, is cited, comments attributed to various individuals are taken from interviews conducted by the author for this research.
Reagan administration's pro-market stance. However, the OMB did not become involved in rulemakings at the Commission.

38 The Reagan administration did try to oversee regulatory agencies through the Office of Management and Budget. President Reagan issued Executive Order 12291 in February 1981, less than one month after taking office. While the independent regulatory agencies and commissions, such as the FERC, were specifically excluded from the requirements of this executive order, it is still interesting to see how one administration sought to control the federal regulatory apparatus. Regulatory agencies were required to submit "major rules" along with a regulatory impact cost/benefit analysis to the Director of OMB for review prior to publication of the notice of proposed rulemaking and then again prior to publication of the final rule. Major rules were those that were likely to have the following effects: at least $100 million annually on the economy, major price or cost increases to consumers, industries, or government, and adverse effects on competition, productivity, employment, or investment. The OMB Director could ask the agency to delay publishing the proposed or final rules while the review was being conducted. The agency would have to include in the rulemaking docket its response to any objections from the Director. See The President; Executive Order 12291--Federal Regulation; Issued February 17, 1981, 46 Fed. Reg. 13,193 (February 19, 1981).

39 One point of interaction between the OMB and the Commission is the clearance of data collections mandated by the Paperwork Reduction Act of 1980. For example, in its 1986 budget request, the FERC noted that the OMB would review and clear approximately twenty data collections in the coming fiscal year in an effort to reduce the burdens on the respondents associated with filling out the forms. This clearance would cost the Commission around one hundred thousand dollars. See U.S., Congress, House, Committee on Appropriations, Energy and Water Development Appropriations for 1986, Hearings before a Subcommittee of the Committee on Appropriations, Part 4. 99th Cong., 1st sess., 1985, p. 2054.

In August 1987, the FERC withdrew three pending data collection rulemakings from OMB review. The Commission stated that it needed to modify the data requests in light of the issuance of Order No. 500. There were also unconfirmed rumors that the FERC feared that OMB would reject the proposals. See "FERC Pulls Back Three Major Pending Rulemakings from OMB Review," Inside F.E.R.C., August 31, 1987, pp. 2-3.
Another actor in the FERC environment is the Department of Energy (DOE). The FERC is located within the DOE and the Commission is required to consider any rules proposed by the Department. The DOE did file comments in some of the rulemakings that are the subject of this study and in another recent case, which does not concern us here, the Department submitted a proposed rule that became the base for the subsequent FERC order.

The FERC, however, does have a long history of independence as the Federal Power Commission. In fact, the statute establishing the DOE stated that the FERC would not be responsible to or under the supervision of any officer of the DOE in the execution of its statutory responsibilities. Thus, the Commission was part of but also independent from the Department and the Act specifically referred to the FERC as an independent regulatory commission. The statute also provided that any decision by the FERC on matters within its jurisdiction would be final agency action and not subject to review by the Secretary or any other official of the DOE.\(^\text{40}\)

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\(^{40}\) See the Department of Energy Organization Act, 42 U.S.C. secs. 7171(a)(d), 7172(g), and 7176(1988). See also "DOE and FERC: The Meaning of the Dotted Line," *FERC Monitor*, March 8, 1984, p. 3. President-elect Reagan's transition team suggested moving the FERC out of the DOE but no such move was made. See "Transition Team Envisions Looser FERC Ties to DOE, But No Radical Change," *Inside F.E.R.C.*, January 19, 1981, pp. 1-2. According to this article, the FERC was placed within the DOE because then Secretary of Energy James Schlesinger sought greater control over energy policy, including the Commission's price setting authority. The sources quoted did not believe that the DOE had interfered with the FERC up to that point and one noted that ex parte rules would have been a block to intervention.
The DOE Act specifies that the Secretary must identify the portion of the annual departmental authorization and appropriations requests to Congress that are meant for the FERC. A statement by the Commission assessing its needs and showing the amount that it had requested in its presentations to the Secretary and the OMB must also be included. The Commission was also authorized (or required) to submit directly to the appropriate congressional committees any proposed legislation or testimony that it had prepared for Congress but had sent to the Secretary, the President, or the OMB.41

There are several areas where the Commission shares responsibilities with the Department. An important area for purposes of this study is rulemaking. The Secretary of Energy can propose rules for the FERC to consider. These proposals can pertain to any area of the Commission's authority and the Secretary has the power to set a deadline for Commission action on the rule. The rulemaking that resulted in Order No. 451 allowing the price of old, regulated gas to rise, mentioned briefly in Chapter 4, was proposed by the Department of Energy. The Secretary of Energy is the only party with the power to impose a time limit on the Commission although any party could request the FERC to initiate a rulemaking. The FERC has complete discretion to accept or reject the rule proposed by the Secretary.42

41 See 42 U.S.C. sec. 7171(j)(1988). A source with the Reagan transition team noted in early 1981 that the Secretary of Energy had not changed the Commission's budget requests up to that point. See "Transition Team Envisions," p. 2. It should also be noted that, as mentioned below, by the end of the Reagan presidency the FERC was raising its funds entirely from fees levied on those entities that it regulated.

42 See 42 U.S.C. sec. 7173(a-b)(1988). See also "DOE and FERC," pp. 3-4. In addition, the DOE can participate in FERC rulemakings just like any other party. The DOE Act authorizes the Secretary to intervene or (continued...
On the other hand, the Secretary must inform the FERC of any rule that the Department intends to issue and seek the Commission's determination of how the regulation would affect the FERC. If the Commission determines that the rule would "significantly affect any function" within its jurisdiction, it must then solicit comments from the public and afterward confer with the Secretary. The FERC could agree to the rule as proposed, suggest changes, or recommend that the rule not be adopted. The DOE could then issue the original proposal only if the FERC had approved. Otherwise, the Department must modify the regulation to conform "in all respects" with the changes that the Commission suggested. The Secretary might also decide not to issue any rule.43

42(...continued)

participate in any proceeding before the FERC. The Secretary must comply with the rules concerning interventions. See 42 U.S.C. sec. 7175(1988). The Department was a participant in the Order No. 436 proceeding. In early 1985 DOE Deputy Secretary Danny Boggs remarked that the Notice of Inquiry that the Commission had just issued on transportation was "a good one" and that the Department would be active before the FERC in 1985. This activity would be through participation in the rulemaking or through "statutory powers," or both. See "Decontrol Still on DOE Agenda but Not Yet in the Form of Legislation," Inside F.E.R.C., January 7, 1985, p. 3. As noted in Chapter 4, however, an official in the Office of Regulatory Analysis did not feel that the DOE had been very influential in the Order No. 436 process.

43 See 42 U.S.C. sec. 7174(1988). See also "DOE and FERC," pp. 3, 4-5. Before serving as Chair of FERC, Martha Hesse was assistant secretary of DOE for management and administration. In an interview with Inside F.E.R.C. soon after coming to the Commission, Hesse was asked whether her background at the DOE would result in the Department having more influence at the FERC than it had had up to that point. Hesse stated that she was "mindful" that the FERC was an independent regulatory agency and "we'll make certain that we follow the regulations that govern that." See "Interview: Hesse on Order 436, Managing Case-load and the Task Ahead," Inside F.E.R.C., November 10, 1986, pp. 5, 7.
An assistant to FERC Chair O'Connor observed that the "issue people" at the DOE could have impact at the FERC if they were concerned about an issue and sought to have input. Usually, however, they did not seek to influence the FERC. Much depended on the personalities of the individuals involved.

A former FERC Chair commented on the independence of the Commission from the DOE. He observed that the FERC prepared its own budget and that there was no interference from the DOE (or the Office of Management and Budget). The dotted line between the Secretary of Energy and the Commission meant whatever the incumbents wanted it to mean. The former Chair remarked that he applied the ex parte rules (described below) to the DOE as well as to other outsiders.

Congress

The Congress would be expected to play an important role in the regulatory environment of the FERC, although Congress as a whole appears to play less of a role in the ongoing gas policy subsystem than do certain of its committees. While the Congress enacted major natural gas legislation in 1938 and 1978, it was not able to do so again during the Reagan term despite the attempts of various of its members and the Reagan administration on behalf of decontrol.

The Natural Gas Policy Act (NGPA) was, as noted above, a compromise between those who wanted deregulation of gas prices and those who wanted continued regulation. Both sides got some of what they wanted with "new" gas being deregulated in phases and "old" gas being forever regulated. The law was passed after an eighteen month struggle
in 1977 and 1978 and perhaps would have been defeated if it had not been made a part of the total National Energy Act package."

A brief history of some of the legislative events during the Reagan term shows how controversial this policy area was at that time, how difficult it was to pass legislation and thus how limited the legislative option was. In 1982, pressure increased on Congress to take action on then rising gas prices. While demand for gas had dropped 3 percent below the 1981 demand level, residential prices rose nearly 18 percent from 1981 to 1982. Many experts blamed the NGPA with its schedule of price increases. Congress, however, could not reach a consensus on whether to roll back prices to previous levels or deregulate prices entirely. Over 100 bills dealing with natural gas were introduced.

President Reagan's Cabinet recommended that the administration push for full deregulation of gas prices. Reagan had made a pledge during the 1980 campaign that his administration would take such action, but rising prices brought calls for more price regulation from consumer groups. The industry itself was divided over what course of action should be taken. Senior congressional Republicans urged the President not to propose decontrol and on March 1, 1982, Reagan announced that he would not send any bill to Congress.

In December 1982, the Senate defeated a measure that would have frozen gas prices at the October 1982 level until January 1, 1985. The proposal would have also empowered the FERC to annul or modify take-or-pay provisions in contracts.

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Take-or-pay provisions require pipelines to pay producers for certain amounts of gas regardless of whether or not they (pipelines) take the fuel or can sell it to their own customers, such as local distributors. Because of these contracts, pipelines often took large amounts of high-priced gas in order to satisfy their contractual commitments even though cheaper gas might have also been available. The passthrough of the cost of this higher-priced gas to consumers was a major cause of the demand in 1982 for tougher price controls. After defeating the proposal, the Senate adopted a resolution calling on the FERC to consider ways to correct the contract problem.

As prices continued to rise in 1983, constituents continued to exert pressure on Congress. Some Republican members of the House and Senate called for price controls.

In February 1983, President Reagan sent a natural gas proposal to Congress. The bill would have deregulated any gas for which a new contract was signed or an old contract was renegotiated. Gas sold under existing contracts would have remained under price controls. The administration plan would have allowed pipelines or producers, beginning in 1985, to break any contract that was not renegotiated. An alternative bill, proposed by a consumer group, would have rolled back the price of new gas to 1982 levels and delayed until 1987 the NGPA mandated expiration in 1985 of price controls on new gas.

The Senate Energy and Natural Resources Committee reported a bill on July 26, 1983. This measure provided for the decontrol of all gas prices by January 1, 1986. The full Senate rejected the bill on November 15, 1983. Minutes earlier, the Senate had rejected a measure that was similar to the consumer group's bill, described above. No Senate action was taken in 1984.

In the House, the Subcommittee on Fossil and Synthetic Fuels of the Energy and Commerce Committee approved a bill on July 29, 1983,
that made little change in the existing regulation. Subcommittee Chair Philip Sharp, Democrat of Indiana, and Committee Chair John Dingell, Democrat of Michigan, then proposed a new bill that would have kept price controls on old gas, rolled back new gas prices to September 1982 levels, and kept controls on new gas past January 1, 1985. Only gas that was put on the market for the first time after January 1, 1985 would have been deregulated. A test vote in the full Energy and Commerce Committee went against this bill.

In April 1984, the Energy and Commerce Committee approved the bill, passed by the Fossil and Synthetic Fuels Subcommittee the previous year, that had made few changes in existing law. The bill was modified, however, to include provisions to force pipelines and producers to renegotiate their contracts. Price rollbacks were not included in the measure.

The Reagan administration opposed this bill, however. Few members of the House supported it. Democratic members complained that the legislation was a no-win issue. On September 26, 1984, House Speaker Thomas P. O’Neill said that the gas legislation was "just too controversial" and was dead.\(^{45}\)

Given the inability of the Congress as a whole to send clear signals to the FERC at this time except on rare occasions (although the defeat of the legislation could certainly be a clear signal), the main and consistent means of Congressional interaction and influence with the FERC was (as the literature on subsystem politics would lead us to expect) through the legislative branch's committees and subcommittees. The House and Senate Appropriations Committees (particularly the subcommittees on energy), the House Energy and Commerce, and Senate Energy and Natural Resources Committees are the groups that would have potential influence on the FERC.

It might be expected that representatives of major gas producing states and gas consuming states would be attracted to these committees. Table 2.1 lists the top twelve gas producing and the top twelve gas consuming states for 1987. Tables 2.2 and 2.3 list the memberships during the 100th Congress (1987-88) of the House and Senate Appropriations Subcommittees on Energy, the House Energy and Commerce Subcommittee on Energy and Power (successor to Fossil and Synthetic Fuels), and the Senate Energy and Natural Resources Committee.

The tables show that members of the House and Senate from the major gas producing and consuming states constituted large portions of the memberships of these energy related subgroups in the 100th

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46 It should be noted that Congress was able to pass one important natural gas related bill during the Reagan term. In 1987 Congress repealed the Fuel Use Act which had been enacted in 1978 along with the Natural Gas Policy Act. The Fuel Use Act had prohibited the use of oil or natural gas as primary energy sources in new electric power plants. The law had seemed necessary in 1978 because it was thought that oil and gas were going to become scarce. In the 1980s, however, there was a surplus of natural gas. President Reagan signed the bill into law in May 1987. See Congressional Quarterly Inc., \textit{Congressional Quarterly Almanac, 100th Congress, 1st session, 1987, Volume XLIII} (Washington, DC: Congressional Quarterly Inc., 1988), pp. 323-324.
Congress. Five of the nine members of the House Appropriations Subcommittee on Energy and Water Development, and six of the thirteen members of the Senate Appropriations Subcommittee on Energy and Water Development were from the major gas producing or gas consuming states. Sixteen of the twenty-one members of the House Energy and Commerce Subcommittee on Energy and Power and ten of the nineteen members of the Senate Committee on Energy and Natural Resources were from the major gas producing or consuming states.\textsuperscript{47}

\textsuperscript{47} These numbers for the energy committees are somewhat disproportionate to the memberships of the whole House and Senate. For the House, 55.5 percent of the Appropriations subcommittee and 76.2 percent of the Energy and Commerce subcommittee members were from major gas producing or consuming states. This compared with 262 Representatives or 60.2 percent of the entire House. For the Senate, the corresponding numbers were 46.2 percent of the Appropriations subcommittee and 52.6 percent of the Energy Committee compared with 38 percent of the whole membership.

The extent to which member decisions to join certain committees result in policy biased groups (i.e. committees or subcommittees composed of preference outliers) is an important issue being considered recently in the literature. For example, see Richard L. Hall and Bernard Grofman, "The Committee Assignment Process and the Conditional Nature of Committee Bias," \textit{American Political Science Review} 84 (December 1990):1149-1166; and John Londregan and James M. Snyder, Jr., "Comparing Committee and Floor Preferences," \textit{Legislative Studies Quarterly} 19 (May 1994):233-266. See also Bryan D. Jones, Frank R. Baumgartner, and Jeffery C. Talbert, "The Destruction of Issue Monopolies in Congress," \textit{American Political Science Review} 87 (September 1993):657-671.
### Major Producing States

<table>
<thead>
<tr>
<th>State</th>
<th>Gross Production in 1987 (in MMcf)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>6,687,689</td>
</tr>
<tr>
<td>Louisiana</td>
<td>5,204,984</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>2,004,797</td>
</tr>
<tr>
<td>Alaska</td>
<td>1,694,870</td>
</tr>
<tr>
<td>New Mexico</td>
<td>845,478</td>
</tr>
<tr>
<td>Wyoming</td>
<td>733,478</td>
</tr>
<tr>
<td>California</td>
<td>527,486</td>
</tr>
<tr>
<td>Kansas</td>
<td>458,426</td>
</tr>
<tr>
<td>Utah</td>
<td>261,911</td>
</tr>
<tr>
<td>Mississippi</td>
<td>224,983</td>
</tr>
<tr>
<td>Colorado</td>
<td>186,286</td>
</tr>
<tr>
<td>Ohio</td>
<td>166,593</td>
</tr>
</tbody>
</table>

### Major Consuming States

<table>
<thead>
<tr>
<th>State</th>
<th>Gas Delivered to Consumers in 1987 (in MMcf)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Texas</td>
<td>2,867,751</td>
</tr>
<tr>
<td>California</td>
<td>1,889,118</td>
</tr>
<tr>
<td>Louisiana</td>
<td>1,147,961</td>
</tr>
<tr>
<td>Illinois</td>
<td>863,261</td>
</tr>
<tr>
<td>New York</td>
<td>749,004</td>
</tr>
<tr>
<td>Ohio</td>
<td>697,895</td>
</tr>
<tr>
<td>Michigan</td>
<td>635,568</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>584,930</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>467,942</td>
</tr>
<tr>
<td>New Jersey</td>
<td>418,018</td>
</tr>
<tr>
<td>Indiana</td>
<td>406,661</td>
</tr>
<tr>
<td>Georgia</td>
<td>297,249</td>
</tr>
</tbody>
</table>


Table 2.1: Major gas producing and gas consuming states, 1987.
House Appropriations Subcommittee on
Energy and Water Development

<table>
<thead>
<tr>
<th>Democrats</th>
<th>Republicans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tom Bevill of Alabama</td>
<td>John T. Myers of Indiana *</td>
</tr>
<tr>
<td>Lindy Boggs of Louisiana *</td>
<td>Virginia Smith of Nebraska</td>
</tr>
<tr>
<td>Bill Chappell, Jr. of Florida</td>
<td>Carl D. Pursell of Michigan *</td>
</tr>
<tr>
<td>Vic Fazio of California *</td>
<td></td>
</tr>
<tr>
<td>Wes Watkins of Oklahoma *</td>
<td></td>
</tr>
<tr>
<td>William Hill Boner of Tennessee</td>
<td></td>
</tr>
</tbody>
</table>

Senate Appropriations Subcommittee on
Energy and Water Development

<table>
<thead>
<tr>
<th>Democrats</th>
<th>Republicans</th>
</tr>
</thead>
<tbody>
<tr>
<td>J. Bennett Johnston of Louisiana *</td>
<td>Mark O. Hatfield of Oregon</td>
</tr>
<tr>
<td>John C. Stennis of Mississippi *</td>
<td>James A. McClure of Idaho</td>
</tr>
<tr>
<td>Robert C. Byrd of West Virginia</td>
<td>Jake Garn of Utah *</td>
</tr>
<tr>
<td>Ernest F. Hollings of S. Carolina</td>
<td>Thad Cochran of Mississippi *</td>
</tr>
<tr>
<td>Quentin N. Burdick of N. Dakota</td>
<td>Pete Domenici of N. Mexico *</td>
</tr>
<tr>
<td>James R. Sasser of Tennessee</td>
<td>Arlen Specter of Penna. *</td>
</tr>
<tr>
<td>Dennis DeConcini of Arizona</td>
<td></td>
</tr>
</tbody>
</table>


Table 2.2: Membership of the House and Senate Appropriations Subcommittees on Energy, 100th Congress (1987-88).
### House Energy and Commerce
#### Subcommittee on Energy and Power

<table>
<thead>
<tr>
<th>Democrats</th>
<th>Republicans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Philip R. Sharp of Indiana *</td>
<td>Carlos J. Moorhead of Calif. *</td>
</tr>
<tr>
<td>Doug Walgren of Pennsylvania *</td>
<td>William Dannemeyer of Calif. *</td>
</tr>
<tr>
<td>Al Swift of Washington</td>
<td>Jack Fields of Texas *</td>
</tr>
<tr>
<td>Mike Synar of Oklahoma *</td>
<td>Michael G. Oxley of Ohio *</td>
</tr>
<tr>
<td>Billy Tauzin of Louisiana *</td>
<td>Michael Bilirakis of Florida</td>
</tr>
<tr>
<td>Bill Richardson of New Mexico *</td>
<td>Dan Schaefer of Colorado *</td>
</tr>
<tr>
<td>John Bryant of Texas *</td>
<td>Joe Barton of Texas *</td>
</tr>
<tr>
<td>Terry Bruce of Illinois *</td>
<td>Sonny Callahan of Alabama</td>
</tr>
<tr>
<td>Edward Markey of Massachusetts</td>
<td></td>
</tr>
<tr>
<td>Mickey Leland of Texas *</td>
<td></td>
</tr>
<tr>
<td>Ron Wyden of Oregon</td>
<td></td>
</tr>
<tr>
<td>Ralph M. Hall of Texas *</td>
<td></td>
</tr>
<tr>
<td>Wayne Dowdy of Mississippi *</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Senate Committee on Energy and Natural Resources</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Democrats</th>
<th>Republicans</th>
</tr>
</thead>
<tbody>
<tr>
<td>J. Bennett Johnston of Louisiana *</td>
<td>James A. McClure of Idaho</td>
</tr>
<tr>
<td>Dale Bumpers of Arkansas</td>
<td>Mark O. Hatfield of Oregon</td>
</tr>
<tr>
<td>Wendell H. Ford of Kentucky</td>
<td>Lowell Weicker of Conn.</td>
</tr>
<tr>
<td>Howard M. Metzenbaum of Ohio *</td>
<td>Pete Domenici of N. Mex.*</td>
</tr>
<tr>
<td>John Melcher of Montana</td>
<td>Malcolm Wallop of Wyoming *</td>
</tr>
<tr>
<td>Bill Bradley of New Jersey *</td>
<td>Frank Murkowski of Alaska *</td>
</tr>
<tr>
<td>Jeff Bingaman of New Mexico *</td>
<td>Don Nickles of Oklahoma *</td>
</tr>
<tr>
<td>Timothy E. Wirth of Colorado *</td>
<td>Chic Hecht of Nevada</td>
</tr>
<tr>
<td>Wyche Fowler, Jr. of Georgia *</td>
<td>Daniel J. Evans of Wash.</td>
</tr>
<tr>
<td>Kent Conrad of North Dakota</td>
<td></td>
</tr>
</tbody>
</table>


Table 2.3: Membership of House Subcommittee and Senate Committee on Energy, 100th Congress (1987-88).
The foregoing comments are not meant to suggest that a member of Congress has sought a position on an energy-related committee or subcommittee merely because his or her state is a major producer or consumer of natural gas. Various studies have shown that Representatives and Senators want to be on a particular committee for a variety of reasons, some of which are unrelated to the member's constituency. In addition, these particular committees and subcommittees deal with other issues and policies besides natural gas regulation so that there are other reasons for members to join them.

All of that said, however, the fact does remain that natural gas was an important part of the economies of the states from which a major number of the members of the authorization and appropriations committees and subcommittees (at least in the 100th Congress) dealing with energy came. Thus, it would be expected that those members would pay some attention to the FERC and its natural gas policies and attempt to influence those policies even if Congress as a whole was not able to do so.

The role of the House and Senate Appropriations Committees in the Commission's policy environment was considered in interviews with staff from both panels. The staff members claimed that the authorization committees were the most active in terms of being involved in ongoing policy issues and debates rather than the appropriations committees. The House Appropriations Committee staff member said that the authorizing House Energy and Commerce Committee instructs the FERC on the goals and purposes for which funds are to be spent. The Appropriations Committee did not get involved with policies above and beyond appropriating the funds although the Committee was also concerned that the FERC actually spent the money for the designated purposes.

The Senate Appropriations Committee staff member said that the Senate Energy and Natural Resources Committee oversaw the FERC and
that policy related matters were handled by that committee. However, an
occasional rider might be attached to an appropriations bill (as was
attempted in the case of Order No. 436 described in Chapter 4). The
Commission informed the energy subcommittee of Senate Appropriations
on major cases and developments but this was done for informational
purposes only.

An examination of House and Senate Appropriations Committee
hearings on the FERC budget requests during the Reagan administration
supports to some extent these staff views. The House staff member
remarked that his subcommittee was concerned about the Commission's
backlog in processing cases. This was a recurrent topic in the House
hearings. Other housekeeping issues that arose in those proceedings
were the location of the Commission offices, FERC hiring and promotion
of women, and the increasing number of GAO studies of the Commis-
sion.\footnote{The number of GAO studies being conducted at the FERC and the
use of GAO as a tool for intervening at the FERC were discussed at the
fiscal 1984 budget hearings (in February 1983). FERC Chair Butler
observed that approximately twenty studies were in progress at that time
and the Commission provided data that showed it was spending thousands
of hours on the studies (291.2 hours per study per year). The Commis-
sion General Counsel expressed concern that members of Congress were
requesting GAO studies as a means of intervening in ongoing proceedings
at the FERC. He stated that the \textit{Pillsbury} ruling (described below)
required that the Commission "avoid any taint of political influence on a
case." Various members of the subcommittee expressed sympathy for the
FERC. The issue was discussed again two years later when FERC Chair
O'Connor reported that six GAO studies were pending at that point. The
Commission's executive director attributed the decreased number to the
efforts of the Appropriations committee. See U.S., Congress, House,
Committee on Appropriations, \textit{Energy and Water Development
Appropriations for 1984, Hearings before a Subcommittee of the
244-246; and U.S., Congress, House, Committee on Appropriations,
(continued...)}
recurring topic. The House subcommittee repeatedly made the Commission aware of its opposition to any such expenditure of funds. The fact that the Commission's budget was relatively small (around $100 million during this time) and that by fiscal 1989 the agency became self-supporting through the collection of fees from the regulated entities may also have made the work of the Appropriations Committees less controversial.

This is not to say, however, that the appropriations process was entirely devoid of policy discussion or conflict. The hearings before the House subcommittee always contained discussions of policy issues, including topics related to some of the five cases studied here. For example, among the written follow-up questions to the fiscal 1988 House hearings was one asking about the use of section 7 certificates by pipelines to avoid Order No. 436. In the fiscal 1989 House hearings, held in March 1988, Chair Martha Hesse was asked about Commission efforts to

[...continued]


See, for example, the fiscal 1982 hearing in which subcommittee Chair Tom Bevill of Alabama remarked that intervenor participation "never will be" funded by the Appropriations Committee. See U.S., Congress, House, Committee on Appropriations, Energy and Water Development Appropriations for 1982, Hearings before a Subcommittee of the Committee on Appropriations, Part 8. 97th Cong., 1st sess., 1981, p. 1397.

encourage open access transportation and about her views on the take-or-pay issue.  

Similar observations can be made about the Senate appropriations hearings. Recurring housekeeping and monetary issues discussed at those proceedings or in follow-up questions included the location of FERC offices, Commission workload, and the collection of fees from regulated industries to fund the Commission. Policy issues were also raised including the rate of deregulation of gas under the NGPA and block billing. 

In addition, the appropriations committees used their budgetary powers to send messages to the FERC. The case of intervenor funding, noted above, is one such instance. As shown in the various reports accompanying the appropriations bills, the committees not surprisingly used the approved funding levels to communicate. For example, the House Committee denied a Commission request in its proposed fiscal

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1982 budget for an additional $2 million to hire more staff. The Committee stated that the Commission was not using its current staff efficiently and should improve its performance. The Committee remained unsatisfied with the Commission's productivity in subsequent years, voting reductions of $5 million (each year) in the Commission's proposed budgets for fiscal 1984 and 1985. The Senate Committee concurred with the reduction and the reasoning in fiscal 1985.\(^3\)

The appropriations committees also included in their reports on the funding bills general assertions or expectations that the committees might have of the Commission. For example, the Senate Committee reports repeatedly contained language asserting that the law creating the FERC within the Department of Energy "sets out the clear intent of Congress that the Commission be independent from supervision or direction from any other officer of the Department...." The Committee


A FERC congressional liaison official said in an interview that the Commission would tend to be responsive when Congress faulted it for sloppy work, poor management, or slow processing of work. The relatively short tenure of commissioners meant that members of the FERC were not heavily invested in the management style or philosophy "or anything else that went before" and would be more receptive to suggestions to change.
also encouraged the FERC to "give full and fair hearings to all points of view" and inform the public on its actions.\footnote{See, for example, U.S., Congress, Senate, \textit{Energy and Water Development Appropriation Bill, 1983}, S. Rept. 97-673 to Accompany S. 3079, 97th Cong., 2d sess., 1982, p. 136. While feeling that the FERC should listen to all points of view, the Committee also asserted that the Commission was charged with representing the public interest. Thus, it would be "counterproductive" to fund intervenors' participation in FERC proceedings.}

In short, one cannot say that the House and Senate Appropriations Committees were just uninvolved bystanders. They did ask questions and sent messages and did not rubber stamp the Commission budget requests. However, the authorization committee leaders seem to be more prominent in the Commission's environment (from the crude indicators of coverage in the trade press and the fact that the Commission felt it necessary to garner their support for Order No. 436) and thus the focus in this discussion is on the House Energy and Commerce and Senate Energy and Natural Resources Committees.

The impact of Congress on the Commission's membership is naturally very important. In the previous section's discussion of the Reagan presidency's interaction with the FERC, it is noted that the White House was able to select many members for the FERC who reflected the administration's market oriented approach to regulation. Congress was another player in the appointment process not only in its power to confirm nominees but perhaps more importantly in its influence over the selection of the nominees. The White House on at least one occasion sought Senate reaction to a possible nomination (Trabandt) before submitting it for approval.\footnote{See "Gas Industry Keeping Low Profile on Possible Trabandt Nomination," \textit{Inside F.E.R.C.}, March 18, 1985, pp. 1-2. The White (continued...)} Previous affiliation with Congress appears
to be helpful in securing appointment, all other factors being equal. Several of the commissioners who served during the Reagan term had worked previously for Congress, whether for individual members or for the energy committees. These commissioners included Butler, Richard, Trabandt, and Naeve. Their previous affiliation with Congress undoubtedly aided in their appointment to the FERC by providing sponsors for their nominations.\textsuperscript{56}

Another type of congressional influence on FERC membership comes in the form of attempts by members to secure regional or ideological representation on the FERC. There appears to be a conscious effort to have such representation although the members might not always be successful in winning the approval of their specific candidates for commissioner. For example the Texas congressional delegation wrote to President Carter in 1979 in support of a Texan for the Commission’s

\textsuperscript{55}(...continued)

House may have wanted congressional and industry reaction particularly in the case of Trabandt because of rumors that he had offended many people in Congress and in the industry during his service on the Senate Energy Committee staff. Energy Committee Chair James McClure, a Republican, reportedly told the White House that he was not opposed to Trabandt. The gas industry apparently did not react one way or the other to the possible nomination. Sources quoted in this article stated that the industry did not fight the potential nomination because of possible retaliation from Trabandt if he were confirmed. Another reason given was that Trabandt would be only one of five commissioners so that opposing him was not really worth the effort.

\textsuperscript{56} A FERC congressional liaison official stated, however, that members of the Commission who had served on congressional staff did not appear to be more responsive to the Congress than other commissioners. These commissioners took on a new perspective when they joined the FERC and no longer worked for Congress. They had new obligations and "much broader loyalties" than when they worked for the Congress. While such commissioners understood Congress better, it was not clear to the official to what extent this affected their decisions.
"southwestern seat." Eventually, another Texan, David Hughes, was appointed. In August 1983, twenty Senators from the Northeast-Midwest Coalition argued for the appointment of a person to represent the energy consuming states to replace Chair Butler who had announced that he was leaving at the end of his term that October. The Senators suggested four individuals. Raymond O'Connor from New York, although not one of the four, was appointed. When O'Connor left the Commission, several senators sent a letter to the White House urging the appointment of someone who would continue to promote the open access and increased competition mandates of Order No. 436.57

57 In July 1983, House members of the Northeast-Midwest Coalition had written to President Reagan, asking him to restore "a small degree of regional balance" to the FERC. The Coalition had been unsuccessful in a similar attempt the previous year when Oliver Richard from Louisiana had been appointed. In the summer of 1983 the FERC membership included three commissioners from producing states: Butler from Texas who was leaving, Hughes from Texas whose term was expiring in October, and Richard from Louisiana. At the time the House members sent their letter, Raymond O'Connor was being mentioned. When Hughes left in the summer of 1984, he was replaced by Charles Stalon from Illinois. See "Frost-Belt Congressmen Again Have Called for Representation at FERC....," Inside F.E.R.C., July 18, 1983, p. 6; and "Frostbelt Senators Have Recommended Four Current or Former State Regulators....," Inside F.E.R.C., August 15, 1983, p. 2. For the effort of the Texas delegation, see "Two Texans are Vying for FERC's 'Southwestern Seat,' Vacated by Smith," Inside F.E.R.C., October 1, 1979, p. 1. For the account of the effort by the advocates of Order No. 436 after O'Connor had left, see "Wheels Starting to Turn for O'Connor Replacement; Vlcek a Candidate," Inside F.E.R.C., February 3, 1986, pp. 1, 6.

When C. M. Naeve was being considered for nomination in 1985, ten senators led by Bennett Johnston of Louisiana wrote to the White House in his support. The ten included Lloyd Bentsen for whom Naeve had worked and others from some of the major producing states. Richard had announced his plans to resign and the senators apparently wanted to insure that a producing state representative (Naeve was a native of Texas) replaced him. See "White House Nominates Trabandt; Senators Push Naeve to Replace Richard," Inside F.E.R.C., July 1, 1985, pp. 1, (continued...)
A major constraint on congressional intervention into Commission proceedings that was mentioned in some of the interviews conducted for this research is a 1966 ruling by the U.S. Fifth Circuit, *Pillsbury Company v. Federal Trade Commission.* The case involved allegedly improper influence by congressional committees on a pending matter before the FTC. Pillsbury had acquired two of its competitors in 1951 and 1952 and the FTC was considering the government’s case that these acquisitions were prohibited under the antitrust laws. In April 1953, an FTC hearing examiner had granted Pillsbury’s motion to dismiss but the Commission had overturned this decision in December of that year. Subsequently evidence was introduced in the case over the course of several years. The congressional hearings that were the basis of the court challenge were held by the antitrust subcommittees of the House and Senate Judiciary Committees in May and June of 1955. The Senate proceedings were particularly troublesome for the court which quoted them at length.

At the time of the hearings, the Commission was still receiving evidence in the case which was pending before the hearing examiner. The examiner’s initial decision would not be issued until February 1959 with the Commission decision following in December 1960. The Chair of the FTC, Edward F. Howrey, testified before the Senate subcommittee in

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57(...continued)
5-6. The move on behalf of Naeve probably should be considered more of a push for interest group representation than regional representation. In the case of natural gas, however, there is significant overlap.


59 Ibid., pp. 956-962.
June 1955 and faced critical questioning, particularly from Senator Estes Kefauver, over the Commission's interpretation of the antitrust laws.\(^6\)

In its December 1953 order the FTC had allowed Pillsbury to introduce evidence to counter the charge that its acquisition of the two competitors would substantially lessen competition. In June 1955 it appeared that this process was going to proceed indefinitely. In their questions and comments (i.e. those forming the basis of Pillsbury's court challenge), the senators argued that the Commission had misinterpreted the law and the intent of Congress by allowing the lengthy proceeding. Congress had sought to stop monopolies quickly and the FTC was wrong when it held that merely showing that a company would increase its market share greatly after a merger did not satisfy the law's requirement of proof that such a merger would substantially lessen competition.\(^6\)

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\(^6\) In addition to the then chair of the Commission, others testifying before the subcommittee included another commissioner who served on the FTC both at the time of the Senate hearing and at the time of the Commission's final decision in the Pillsbury case in 1960. The General Counsel of the Commission also attended the hearings. He was the FTC Chair when the final order, which he authored and which was the object of the court challenge, was issued. A third FTC official attending the hearings was the Director of the Commission's Bureau of Litigation. His then assistant was a commissioner at the time of the final decision. In short, of the four commissioners who participated in the final FTC order in the Pillsbury case two were "substantially exposed" to any "interference" from the Senate hearings and a third may have been "indirectly" exposed because his boss had been present. See ibid., p. 956.

\(^6\) Ibid., pp. 955-956. See, for example, the following quotes from Senator Kefauver cited by the court on the way that the FTC was conducting the Pillsbury case and on congressional intent with respect to the antitrust laws. "The thing has been going on ever since December 1953, and the hearing examiner is still hearing all this, that and the other, under your rule of reason. When does this terminate?" "I think Congress expected that where there was manifestly a lessening of competition, under the amended Clayton Act a merger should not take place." "It (continued...)
Howrey finally stated that Senator Kefauver's questioning was presenting a great challenge to the judicial process in Pillsbury because he was participating in that proceeding as a quasi-judicial officer. Kefauver observed that perhaps Howrey "should not have answered my questions." Howrey then announced that he was disqualifying himself from further participation in the Pillsbury case because of Kefauver's questioning "about my mental processes in it." He told Kefauver that he had probed too deeply into the "quasi-judicial mind" in Pillsbury.52

In their opinion, the judges stated that the Senate hearings were an "improper intrusion" by the Committee into the proceedings at the FTC. They "were of such a damaging character" that other members of the Commission in addition to Howrey should have disqualified themselves from further participation in the Pillsbury case. The judges were reluctant to intrude into the proceeding so long after the merger had occurred but "common justice to a litigant" required that they vacate and remand the Commission's order.63

Congressional investigation of agency decision making in a case pending before an administrative agency (and thus into that agency's judicial functions) caused the judges to be concerned with the right of the

\[\ldots\text{continued}\]

would seem to me by applying the rule of reason and running the record up to 9,000 pages with more to come, and bringing in every possible economic factor ... that the Federal Trade Commission is rather taking over the prerogative of congressional intent." "It was never the intention of the Judiciary Committee of the House ... that the new amendment to section 7 of the Clayton Act should be enforced, as you have enforced it, on the basis of Sherman Act tests." Ibid., pp. 959-960.

52 Ibid., p. 961.

53 Ibid., p. 963. In remanding the case back to the FTC, the court concluded that the Commission was not permanently incapable of making a decision in the matter because of the passage of time and changes in its membership. See ibid., p. 965.
party involved to a fair trial. The court was also concerned with the party's right "to the appearance of impartiality," requiring that those exercising judicial powers be free from "powerful" external influences. The Senate proceeding had sacrificed the appearance of impartiality. The judges sought to protect the rights of parties in pending cases while not restricting the "legitimate" exercise of congressional investigative powers. The court's purpose was to "preserve the integrity of the judicial aspect of the administrative process."\(^{64}\)

The *Pillsbury* decision has been cited at various instances, usually by Commission officials as an explanation for why they cannot comment or testify in a congressional hearing on a particular topic. Two examples described briefly here are illustrative. In 1983, FERC Chair C. M. Butler decided not to testify before a Senate Government Affairs subcommittee's hearing on natural gas imports. Butler wrote to the subcommittee chair, Senator Charles Percy, explaining that a case concerning a pipeline's imports of liquefied natural gas from Algeria was pending before the FERC. In a previous appearance several months earlier, Butler stated that he had been subjected to "sharp criticism" and "interrogation" on his views in the case and to "strongly worded views about how the commission should rule" in that ongoing proceeding. The FERC had to protect its decisionmaking process from any intervention from Congress that would "undermine its integrity." Citing *Pillsbury*, Butler stated that the previous hearing had been an "unconstitutional intrusion" into the rights of the parties involved in the case. The only difference from *Pillsbury* was that the FERC "notwithstanding legislative pressure to the

\(^{64}\) Ibid., p. 964.
contrary" had issued an opinion that went against the views expressed at the congressional hearing.⁶⁵

In 1984, FERC Chair Raymond O’Connor refused to appear before a House hearing on legislation setting annual charges for use of federal dams. At that time, the Commission was considering on rehearing a rule that would also have established such charges. Referring to Pillsbury, O’Connor wrote to the subcommittee chair that "any communication with Congress on the merits of a pending proceeding which goes beyond a mere explanation of past actions has the potential to be seen by a reviewing court as impairing the impartiality of a commission decision." Echoing Butler, O’Connor said that the FERC had to protect its "decisional process from even the appearance of congressional intervention" even if that intervention would not result in reversal by the courts.⁶⁶

An aide to Commissioner Sousa noted that the Commission performed various functions for Congress. He stated that "we take a lot of heat for Congress. Congress likes it that way." Members might criticize the Commission, "preaching fire and brimstone" on "specific issues at specific times," but the aide stated that most members do not want to "touch it [natural gas regulation] with a ten foot pole." He observed that the NGPA had been "excruciating" and "painful" for Congress to grapple

⁶⁵ See "Butler Refuses to Appear Before Percy, Cites Unconstitutional Intrusion," Inside F.E.R.C., August 1, 1983, pp. 1, 5. Percy responded that the earlier hearing and the proceeding where Butler refused to appear were "a fully appropriate exercise" of congressional oversight responsibilities. He was not satisfied with Butler’s arguments but granted the FERC Chair’s request not to testify. See "Percy Scolds Butler, Defends Gas-Import Hearings as 'Fully Appropriate,'" Inside F.E.R.C., August 8, 1983, p. 8.

with and finally pass and Congress did not want to have to deal with it at any time in the future.

A few observations made in interviews conducted for this research shed light on relationships in the gas policy subsystem. Congress appeared to be relatively satisfied with the Commission's performance during the Reagan term and that may account for its apparently lesser (than industry) role. For example, a member of the FERC during the Reagan administration commented that he had not received much input from individual members of Congress except for occasional letters concerning constituent matters. However, the FERC had to report to congressional committees the members of which would let it know if they were not happy. The FERC did not want Congress to be too upset with its performance although Congress did defer to agencies.

A House Energy and Commerce Committee staff member characterized the Energy and Power subcommittee as just an incremental audience for the Commission which had a far larger audience. Congress was a remote influence while the industry and the economic ideology of the Commissioners were more important influences. The Commission was more concerned about what the courts might say and less about what the Energy and Power subcommittee might think. The staff member felt that Congress was generally satisfied with natural gas regulation and increased competition as administered by the FERC. The Congress had not played a major role in the developments. The Commission, particularly Chairs O'Connor and Hesse and Commissioner Stalon, had led the effort to change natural gas regulation with more people in the country especially consumers gaining more than they lost. The staff member felt that the FERC had done "a damn good job."

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67 Any influence of Representatives John Dingell and Philip Sharp as (continued...)
A senior staff member from the Senate Energy and Natural Resources Committee said that the Committee followed court decisions on the Commission, depending on what may be happening in the case, and staff followed events at the Commission. Staff had written memoes about major FERC-related court decisions, such as *Associated Gas Distributors*, describing the implications of the decisions for Committee members. The Commission, however, did not seek advice specifically from the Committee on how to respond to court decisions in any of the cases under study here. If Congress were consulted, the staff member observed that the FERC "would get 435 different opinions in the House and 100 different opinions in the Senate and they've probably got enough different opinions within the effected industries." The FERC did not seek legislation to overturn any of the court decisions.68

67(...continued)
Chairs of the Committee on Energy and Commerce and its Subcommittee on Energy and Power respectively was personal. It was the power to say, "deal with me. Do things as time goes by that make me generally happy. Give me half a loaf. Don't outrage me." Dingell or Sharp might indicate that he did or did not like a policy in general and the Commission would try to prevent any "vendettas" from occurring and accommodate. The Commission had a "rough sense" of Dingell's and Sharp's views on issues and when it might be close to going against the wishes of the Chairs. But this sense was "understated" because there was not detailed contact between the Chair of the Committee, subcommittee, and the FERC.

The staff member noted that the Commission occasionally did seek support for its policy initiatives to avoid any political backlash and that the Energy and Power subcommittee had assisted. Disappointed litigants did not come to the Congress as frequently to overturn Commission decisions, realizing that they had to deal with the FERC. The Commission's relationship with the subcommittee was informal and not contentious. There were some low-key attempts by members to influence the Commission. Congress was mainly concerned about the Commission's more visible policies (such as transportation).

68 Another senior staff member from the Senate Energy Committee (continued...)
A FERC congressional liaison official characterized the Commission/Congress relationship as a balancing process. The Commission pursued its regulatory goals and tried to convince Congress of the value of its policies while also seeking to be responsive to the authorizing and appropriating committees. The official noted that Representative Dingell had once adamantly opposed deregulation of natural gas, declaring that it would occur "over my dead body." As a result of an "education process" Dingell had been convinced that decontrol should take place, but "you need to let them [Congress] know and sometimes they won't agree with you."

The Courts

The courts are an important part of the FERC regulatory environment as they are called upon repeatedly to review Commission actions. Their orders make demands on the Commission and if there is subsequent review of the Commission's response to a court order, the judiciary would have the opportunity to reinforce its prior instructions to the FERC. This was the case in three of the five case studies discussed in the next chapter.69

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68(continued)

remarked that that group was not very active in influencing the Commission's policymaking in the five cases under study here. However the Commission knows "we're here". Influence might be more "implicit" as the FERC knows that the Committee is watching and that "If they do something outrageous, we can be equally as capable of being outrageous." The Commission needed to work within the bounds of what was "generally acceptable."

69 An assistant to FERC Chair O'Connor commented that the courts, especially the D.C. Circuit, were a player in the "ballet" of federal policymaking.
The place of the judiciary in the Commission's environment is provided for by both of the major natural gas regulatory statutes. Judicial review of FERC rules and orders is the main concern here. The Natural Gas Act states that any party involved in any proceeding arising under the Act who feels harmed by the Commission's order may seek review in the U.S. Court of Appeals. The party may obtain review in the circuit in which the natural gas company that is the object of the FERC order has its main operations, in any circuit in which said company is located or in the Court of Appeals for the District of Columbia. Before seeking judicial review, however, the person must have first applied with the Commission for rehearing of its order. The party must file its petition with the court within sixty days after the Commission has issued its order on the party's application for rehearing. When the petition is filed and the court has received the record of the Commission proceeding, the judges then have exclusive jurisdiction "to affirm, modify, or set aside such order in whole or in part." The Commission is free to modify its order up to the time that the record is filed with the court. The commencement of these judicial proceedings under the Natural Gas Act is not intended to be a stay of the Commission's order unless so directed by the court.

The court is to consider only those objections against the Commission's order that the petitioner already has made to the FERC in its application for rehearing. The party could, however, have "reasonable ground" for not making certain points to the FERC and the court would then be allowed to consider those arguments. Findings of fact by the Commission are to be considered conclusive by the court so long as they are supported by substantial evidence. The judgment of the court is final subject to review by the U.S. Supreme Court.70

The Natural Gas Policy Act contains separate provisions for judicial review of agency orders and rules. The NGPA provisions concerning judicial review of agency orders are very similar to those found in the Natural Gas Act. Parties to proceedings under the Act who feel harmed by the Commission order and who have applied for rehearing before the FERC may obtain review in the D.C. Court of Appeals or in any circuit in which the object of the FERC order is located or has its main business operations. Petitions must be filed with the court within sixty days after the final Commission action on the application for rehearing. The court has exclusive jurisdiction, upon receipt of the official record from the FERC, to affirm or set aside the Commission's order. The FERC is free to modify its order until the record is filed with the court. The court is not to consider arguments unless they have been made previously to the FERC in the application for rehearing (with the same "reasonable ground" caveat found in the NGA). Commission findings of fact are to be considered conclusive if supported by evidence. The Commission's order is not stayed by the commencement of judicial review unless directed by the court. The judgment of the court is to be final subject to review by the Supreme Court.\(^71\)

\(^{71}\) See Natural Gas Policy Act, 15 U.S.C. sec. 3416(a)(1988). In addition to the review procedures just described, the NGA and the NGPA contain provisions specifying other actions or roles for the courts. A few examples from each statute illustrate the variety. The Natural Gas Act authorizes the FERC to seek the aid of a court if a party to a proceeding has refused to obey a subpoena issued by the agency. The Commission is also empowered by the Act to initiate judicial action in federal district court to stop any party who is engaging in or is about to engage in actions that violate the NGA or rules or orders issued under it. The NGA gives the federal district courts exclusive jurisdiction over violations of the law or rules issued thereunder and over any suits brought to enforce the law. See Natural Gas Act, 15 U.S.C. secs. 717m(d), 717s(a), 717u(1988). (continued...)
The NGPA provides for judicial review of agency rules in accordance with certain provisions of the Administrative Procedure Act. Those portions of the law establish the right of a party harmed by agency action to seek aid from the courts even if such litigation would be directed against the United States. The law specifies that the United States may be named as a defendant and a judgment may be made against the United States. The reviewing court may decide relevant questions of law and interpret statutory provisions. The court is authorized to compel agency action "unlawfully withheld or unreasonably delayed" and to overturn agency actions found to be arbitrary, in excess of statutory authority, violative of prescribed procedures, unsupported by evidence, or unwarranted by the facts.\(^7^2\)

Data compiled by the Commission covering late 1983 and early 1984 provide some indication of the activity of the FERC in the courts and thus the amount of potential impact that the courts could have on the FERC during part of the Reagan era. As of January 1, 1984 there were 176 cases pending in various courts including four cases before the U.S. Supreme Court, 154 in the federal courts of appeals, 16 in the federal

\(^7^1\)(...continued)

Like the NGA, the Natural Gas Policy Act empowers the FERC to initiate proceedings in federal district court to stop parties engaging in or about to engage in actions that violate the law. The Commission might also go to the district court to obtain affirmation of any civil penalties that it has levied on violators of the NGPA. The court may affirm or set aside the penalty. The NGPA provides for judicial review of Commission determinations of which gas might qualify for the higher NGPA (such as new gas) prices. See Natural Gas Policy Act, 15 U.S.C. secs. 3413(b)(4), 3414(b)(1), 3414(b)(6)(A)(F)(1988).

district courts, and 2 in state courts. Most (82) of the 154 in the U.S. Circuit Courts were pending in the D.C. Circuit while the Fifth Circuit had the next highest number (19). Of the 154 cases in the appellate courts, many (63) dealt with natural gas regulation. Two of the four Supreme Court cases, three of the district court cases, and one of the state court cases also dealt with natural gas. For the period of October 1, 1983 to April 1, 1984 there were 69 petitions for review of FERC actions filed in the U.S. Courts of Appeals by outside parties. Of decisions made by the Courts of Appeals during this six month period, the FERC was affirmed in 12 cases, affirmed in part and reversed in part in 2 cases, and reversed, remanded or vacated in 6 cases. An additional 8 cases were dismissed for various reasons (Commission motion, withdrawal, settlement, etc.). The Supreme Court and the state courts issued no Commission-related decisions during these six months while the federal district courts issued one decision granting summary judgment to the FERC.73

There is some indication that the FERC was rather successful in court during at least part of the Reagan term. David Willison has examined federal agency cases decided by the U.S. Court of Appeals for the District of Columbia during 1981 to 1984, finding that 66 percent of the 511 decisions were in favor of the agencies. He then looked more closely at the five agencies, the FERC, the Federal Communications Commission, the Interstate Commerce Commission, the National Labor Relations Board, and the Environmental Protection Agency, that were in the court most often. The FERC fared reasonably well: 72 percent of 71 decisions

were favorable. Only the FCC (76 percent of 79 decisions) had a better support score.\footnote{See David H. Willison, "Judicial Review of Administrative Decisions: Agency Cases Before the Court of Appeals for the District of Columbia, 1981-1984," \textit{American Politics Quarterly} 14 (October 1986): 317-327. Commission rulemakings were often the target of litigation during this time. An associate general counsel who was in charge of the rulemaking staff remarked that her office tried to prepare for and withstand a court challenge. She stated that "the bottom line here is good legal work" with her staff researching court and FERC precedents and incorporating those into the rules. Her office tried to advise the Commissioners of their options and the risks of litigation. She did not believe that rulemakings resulted in a disproportionate amount of federal court litigation relative to other FERC actions. However, the fact that rules affected many more parties than other FERC actions increased the chances of litigation. See "Monitor Interview: Lynne H. Church, Associate General Council [sic] for Rulemaking and Policy Coordination," \textit{FERC Monitor}, December 29, 1983, p. 3. Church also commented that when the FERC was implementing a new statute, the Commissioners would have to decide whether to be "conservative or aggressive" in light of the legislative history. The Commission was often willing to risk litigation in order to implement a program that its members felt was in the public interest.}

Several comments from interviews with various Commission officials show a generally positive view of the courts. For example, a member of the Commission during the Reagan administration felt that the courts were fair. The judges were very attentive and wrote good decisions. The courts were there to help and in the \textit{MPC} case had advanced the public agenda by overturning the SMPs. Another former commissioner believed that the FERC/court relationship depended on the issues involved to some degree and on the personalities. The courts provided a useful constraint on agencies. Agencies, thinking that they have the answers, would go "bananas" without judicial review. A third former commissioner felt that the courts were generally fair although sometimes disagreeing with actions taken by the FERC during the Reagan term.
An OPPR staff member said that the courts performed a useful function in natural gas regulation. He observed that the courts are "the final answer." Competing interests that did not win at the FERC needed to be heard. It was not just Commission opinions that were reviewed by the courts but also "everyone's interests all the way down the line."\(^\text{75}\)

Another OPPR staff member felt that the courts were not disruptive and did not interfere in the Commission's work. The courts might have struck down a policy but "you have to get back on track and you have to work with what the court told you." The same would be true if Congress changed the law. An agency loss in the courts meant that the agency policy was not the proper course. The agency must accept the court action as "appropriate" and proceed from that point. The INGAA decision was disruptive, but the Commission was "wrong" in that instance.

An assistant to Commissioner Stalon stated that he did not think of the courts as helping or hindering the Commission in its work. However, he also noted that he did not view Commission decisions as final until the courts had ruled on them. He felt that the gas industry shared this perspective, viewing the Commission's decisions especially those that are

\(^{75}\) An interesting observation on the relationship between the Commission and the courts in one of the cases under study, Maryland People's Counsel, was made by Senator Don Nickles. As described in detail in Chapter 4, Nickles strongly criticized the block billing portion of the Order No. 436 rulemaking. In late 1985 after the Commission had issued Order No. 436 and the request for additional comments on block billing, Nickles filed comments at the FERC seeking rehearing of the rule. Among his assertions was that the FERC had used court decisions "as an excuse and a means to restructure the industry to its liking." See "Alternative on Demand-Reduction Right in Works; Nickles Seeks Changes," Inside F.E.R.C., December 9, 1985, pp. 1, 4a.
contested as "recommended decisions until they’re taken to the court for testing." 76

On the other hand, a former senior OPPR official stated that "I don’t think there’s any question" that the D.C. Circuit in particular "has been a real thorn in the Commission’s side. It’s almost as if it goes out of its way to find a problem." Instead of upholding the Commission, the court would try to find a reason "no matter how trivial" for remanding orders back to the FERC and it was frustrating for the Commission and the industry. Each segment of the gas industry made plans and adjustments based on the Commission’s regulations only to have those regulations later remanded. The former official asked "then how do you unravel all that? How do you get everybody back to where they were? You can’t." The industry may not have liked everything that the FERC had done, but it liked uncertainty even less. While industry trade groups often initiated litigation, the official said that such action did not mean that the entire industry was not happy with the regulations. 77

76 Stalon’s assistant also stated that the Commission had moved rapidly in restructuring the industry and the courts "have not kept pace." The Maryland People’s Counsel decisions had played a role in the implementation of Order No. 436 and the Consolidated Edison decision had played a role in the implementation of Order No. 490. But "by and large the Commission is out running ahead of the court." The Associated Gas Distributors decision had upheld policies that the Commission had promulgated almost two years earlier. Thus, the courts "can be helpful and they can be harmful but by and large they have not stopped the process." The courts had had an impact but they had not stopped the Commission. The Commission had responded to the take-or-pay concerns of the courts in Order No. 500 and had moved on.

77 An OPPR staff member also expressed concern over disruptiveness for the industry caused by litigation. Customers and the various segments of the industry were relying on rules that were not final and could be overturned by the courts. The staff member observed that "everyone here gambles. The producer’s gambling that the Felmont type approach’s (continued...)
A couple of rather humorous instances in the court-FERC relationship should be noted. At one point, the Fifth Circuit faced a problem with judges having to disqualify themselves from cases because of conflict of interest. In one case in early 1983 involving producers and a distributor only four judges from the court could vote on an en banc motion. The other nine had disqualified themselves mainly because they owned interests in gas companies. The Chief Judge noted this problem in his dissent, observing that the Fifth Circuit had created a "gas panel" to hear such cases. This panel had functioned until the number of judges eligible to participate had declined. Four judges "constitute an entirely unacceptable judicial base" for the court to review cases related to the FERC. No party had challenged the authority of the Fifth Circuit to hear gas cases, but the Chief Judge felt that that was due to the discretion of the parties more than to any special confidence in the judges.\(^78\)

The race of parties to the courthouse in order to guarantee that their appeals would be heard by favorable courts was a subject that irritated the D.C. Court in one instance in early 1983. A court receiving an appeal was supposed to transfer that petition to the court hearing an appeal that was filed earlier. The case involved a Commission order concerning an electric utility's purchase of coal from an affiliated supplier. One party, the city of Gallup, New Mexico, sought review in the D.C. Circuit because that court was considered friendlier to consumers. The utility sought review in the 10th Circuit in Denver. On the day that the FERC posted its order, a paralegal from the utility was waiting at the courthouse.

\(^77\) (...continued) ultimately going to be upheld in the Supreme Court." Trying to undo transactions would be impossible. The Commission thus tried to insure that its decisions were right but the courts have still disagreed.

Commission and used a walkie-talkie to signal another utility employee who sent the message via radio and telephone to Denver. Half a minute later, Gallup’s representatives at the FERC quickly signaled colleagues who filed a review at the D.C. Court. The Commission then decided that any petitions filed before 3 p.m. when its order was officially posted were premature and in the second scramble five days later the utility filed nine minutes before the city. The D.C. Court noted that it had no choice but to transfer the case to the Tenth Circuit.79

Such races became unnecessary when a new law took effect in 1988. The law specified that when appeals were filed in more than one circuit court within ten days after an agency issued an order a panel (the Judicial Panel on Multidistrict Litigation) would decide, by random selection from among the courts in which petitions had been filed, where the case would be heard. The selected court could decide to transfer the litigation to another panel, however.80

Interest Groups

Perhaps the most important and influential of the outside forces is the natural gas industry which has an ongoing and multifaceted

79 See "D.C. Court Cites Problems Created by 'Modern Technology' in Appeals Race," Inside F.E.R.C., March 21, 1983, p. 10. For another example, see "By the Toss of a Coin, Review of Order 451-A Falls to 5th Circuit," Inside F.E.R.C., February 2, 1987, pp. 2-3. In this instance, a coin toss at the D.C. Circuit decided which court would hear the case. Mobil Oil Corporation had filed in the Fifth Circuit, claiming that it had won the race to the courthouse over United Distribution Companies (UDC) by one second. However, UDC, which had filed in the D.C. Circuit, claimed that it had won by four-tenths of a second.

relationship with the FERC. The industry and the Commission officially share a common goal: the provision of safe, reliable service to consumers at a reasonable cost. It is in the interest of the FERC that the industry succeed in this pursuit. Federal regulation was blamed at least partly for the major gas shortages in the interstate market during the winter of 1976-77. A result of those shortages was a push for deregulation leading to the Natural Gas Policy Act of 1978. However, the industry needs the Commission as a legitimizer of its actions. An example is the Northern Natural case in which the pipeline sought to offer discount rates to certain industries to retain those customers on its system. Special marketing programs are another example. These programs and rates discriminated against the customers that were not allowed to participate and the FERC was asked to legitimize such discrimination.®

® An episode in 1988 shows the importance that industry places on the Commission's ability to function. In April 1988 the heads of four industry groups, the Interstate Natural Gas Association of America, the Natural Gas Supply Association, the American Gas Association, and the Independent Petroleum Association of America, sent a letter to the White House expressing concern that the Reagan administration was not acting quickly enough to fill pending vacancies at the FERC. At that point, Commissioner Naeve was expected to leave the FERC very soon, Sousa was reportedly thinking about leaving during the summer, Stalon was thought to have little chance of being renominated, and Hesse had been renominated but not confirmed. Because Senate confirmation would "become increasingly problematic" as the election drew near, the industry leaders were concerned about the loss of a quorum at the FERC. The Commission would thus "be unable to take even routine regulatory actions which are essential to the industries it regulates." There were many qualified individuals available to serve and the administration needed to act "expeditiously." As discussed below, the White House did assemble a package of nominations that was confirmed later in 1988. See "Worried that the White House May Be Ignoring Impending Vacancies...," Inside F.E.R.C., April 11, 1988, pp. 2-3. Later in 1988, the president of INGAA said that one of the Association's goals would be legislation lengthening and staggering the Commissioners' terms to avoid (continued...)

131
The natural gas industry is split into three major segments: producers, pipelines, and local distributors. Each of these segments has its own interests and its own ideas on what the FERC should do. Sometimes these interests coincide, but often they do not. Each part of the industry has a major interest group that represents its views in Washington. In addition, there are groups representing consumer interests. Table 2.4 lists the major natural gas related interest groups.

<table>
<thead>
<tr>
<th>Group</th>
<th>Industry Segment</th>
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<tbody>
<tr>
<td>American Gas Association (AGA)</td>
<td>Pipelines/Distributors</td>
</tr>
<tr>
<td>Associated Gas Distributors (AGD)</td>
<td>Distributors</td>
</tr>
<tr>
<td>Citizen/Labor Energy Coalition (CLEC)</td>
<td>Residential Consumers</td>
</tr>
<tr>
<td>Interstate Natural Gas Association of America (INGAA)</td>
<td></td>
</tr>
<tr>
<td>Natural Gas Supply Association (NGSA)</td>
<td>Pipelines</td>
</tr>
<tr>
<td>Process Gas Consumers Group (PGC)</td>
<td>Producers</td>
</tr>
<tr>
<td></td>
<td>Industrial Consumers</td>
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</tbody>
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Table 2.4: Major natural gas industry related interest groups during the Reagan administration.

There are a variety of occasions and methods for FERC-industry interaction. Litigation, the subject of this study, is only one of the ways in which the Commission interacts with the industrial interests. Although used by groups as a last resort after exhausting administrative remedies,

\[^1\](...continued)

any possibility of the lack of a quorum. See "Service Obligation, Gas Supply Top Pipelines' List of Concerns," *Inside F.E.R.C.*, October 10, 1988, pp. 4a-4b. As mentioned above, such legislation was signed into law in 1990.

132
litigation can be an effective means for groups and the FERC to communicate and argue over policy issues. It can also be an effective means for groups to use when attempting to influence and shape FERC policy.

For example, the Associated Gas Distributors tried to persuade the FERC through the written comments of rulemakings, but the group also had gone back to court in certain of the cases to influence the Commission's responses to the original court orders. The INGAA case was one example and attempts to speed up compliance with the court orders in Associated Gas Distributors was another example. In the view of an attorney representing the AGD, the Commission might listen to the AGD but only because it knew that the group was willing to use the courts as a recourse if the Commission did not listen. The AGD would "hold their [the Commission's] feet to the fire," and it was thus worthwhile for the Commission to listen to the group.

An official of the American Gas Association (AGA) remarked that the courts were useful as a "blunt instrument" to move the FERC but one could not get a specific solution or remedy from the court. The agency has a lot of discretion in devising remedies or relief for a problem. But the courts were also "inaccurate" and "slow" instruments for forcing agency action. The Maryland People's Counsel/Associated Gas Distributors case, including Orders No. 436 and 500, had taken years to proceed resulting in an interim relief that was no longer effective. But litigation was "the only game in town," because the legislative option was even more difficult.

The rulemaking process is another point of interaction. As shown in Chapter 4, the FERC solicited comments and advice from interested parties in its rulemakings as mandated by the Administrative Procedure

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82 Special thanks to Professor Aage Clausen for mentioning the idea of litigation as communication to the author.
Act and industry groups were always major participants in these proceedings. If conferences were held as part of the rulemaking, industry representatives presented testimony.\(^3\)

The AGD attorney noted that written comments were the only method for participation before the FERC. Lobbying of the Commissioners was not permitted. The Commission was reportedly more open to lobbying under Martha Hesse but AGD did not want to risk violating ex parte rules (described below). The Commission did not seek advice specifically from the group above and beyond the questions raised in rulemakings. In an oral argument as part of the Order No. 500 docket, the Commission had submitted written questions addressed to specific parties including AGD but this was a rare example. The group was "usually piping up when they just as soon not hear from us."

\(^3\) As shown in Chapters 3 and 4, the Commission often invited outside participation in its rulemakings. As discussed more fully below, FERC Chair Raymond O'Connor welcomed outside input during the course of the Order No. 436 rulemaking. Further evidence that the FERC did not always feel that outsider intervention was a hindrance was the fact that instructions on how to intervene were periodically published in the Commission's newsletter, the *Monitor*. See, for example, "How to Intervene," *FERC Monitor*, November 29, 1984, p. 8.

An observer of the FERC commented that pleadings from the members of the public plus letters from Congress could trigger rulemakings but not always. Much depended on the staff's workload priorities and whether there was time to review the proposals from those outside parties. One interest group representative, John H. Cheatham, general counsel for the Interstate Natural Gas Association of America, stated that FERC rulemakings were a "very useful procedure" that "serve a very real purpose." The procedures played "a real and critical" role in helping the Commission carry out its responsibilities. See "The Makings of Rulemakings," *FERC Monitor*, December 29, 1983, pp. 1-2. An attorney representing producers remarked in an interview that rulemakings were as close as the Commission comes to seeking advice from outside parties.
The Commission's exercise of its regulatory duties and powers constitutes a third major point of interaction. The FERC is always considering rate cases, applications for new services or projects under section 7 of the NGA, or other types of cases (such as abandonment) involving pipelines and producers. The same party, such as a pipeline, may be involved in more than one proceeding at a time. A fourth occasion for interaction occurs at conferences or other public forums that may be sponsored by industry groups. Commissioners often spoke at meetings or conferences sponsored by the interest groups. As one industry representative noted, the commissioners may seek advice or make suggestions in such speeches.

The Commission also acts as a referee in resolving policy disputes arising as the industry tries to furnish reliable service at reasonable cost. As shown very clearly in Chapter 4, the gas industry is not unanimous in its views. Often, the segments are vying with each other as much as they are with the FERC in rulemakings, rate cases, and other proceedings. The fact that the segments do not agree and that Commission decisions will inevitably anger one of the segments is a major cause of much litigation before the Commission and in the courts.

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Some accounts taken from the trade press during the Reagan term show that the various segments of the industry were at odds over such matters as the amount of available gas reserves and renegotiation of contracts to ease the problems of excessive gas prices and supply. While there was a fair amount of sparring and disagreement among the various segments, there were also calls from some members of the industry for cooperation among the sectors. See "AGA, NGSA Take Opposing Views of EIA Data on 1983 Reserve Additions," Inside F.E.R.C., September 24, 1984, pp. 7-8; "Sharp-Hearing Testimony Shows Dim Prospects for Contract Renegotiation," Inside F.E.R.C., February 28, 1983, p. 6; and "In New Era, United We Stand, Divided We Fall, Gas Executives Warn," Inside F.E.R.C., October 8, 1984, pp. 2-3.
The Commission's ex parte regulations are a major restriction on contacts between FERC personnel and the industry or other outsiders. These rules were mentioned by various persons interviewed for this research and should be briefly described.® The purpose of the ex parte restrictions is to "avoid all possibilities of prejudice, real or apparent, to the public interest and persons involved in proceedings pending before the Commission." Parties to proceedings pending before the FERC, their representatives, and intervenors in those proceedings are prohibited from submitting ex parte, off-the-record communications to members of the FERC, members' staff, the administrative law judge involved in the proceeding, or any other employee of the FERC. Commission members and employees are prohibited from requesting and considering such ex parte communications.®

The definition of "ex parte communication" given in the regulations specifies "an oral or written communication relative to the merits of an

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® For example, a representative of a group with a predominantly pipeline membership observed in an interview that contacts between the Commission and the various groups must be open. The Commission cannot contact groups in secret as ex parte rules prohibit communications about cases that are currently before the Commission. Thus, one cannot lobby the FERC in the same manner as one could lobby Congress.

A staff member from OPPR noted that outside groups did not lobby the staff. Ex parte rules were very strict and matters set for hearing could not be discussed with outsiders. Once an administrative law judge began his or her hearing, everything was on the record. The staff member stated that all parties saw the need for the ex parte laws because it assured fairness. Outside interests thus could not effectively (or at least legally) lobby the staff. The competition between the different interests was so great that if any one of them had illegally lobbied or swayed staff, "you'd hear all kind of screaming" once it was discovered.

® See Ex Parte Communications (Rule 2201) at 18 CFR sec. 385.2201 (April 1, 1993). The regulations took effect in 1982 and were amended in 1984.

® See 18 CFR sec. 385.2201(a).
on-the-record proceeding pending before the Commission which is not on the public record and with respect to which reasonable prior notice to the parties is not given. The term "contested on-the-record proceedings" includes proceedings that are required by a law, Commission rule, regulation, or order in a particular case and are to be decided on the basis of a record compiled in a hearing "and in which a protest or a petition or notice to intervene in opposition to requested Commission action has been filed."

If the Commission or presiding administrative law judge receives an ex parte communication in violation of the regulations, they must then require the sender of the message to show why he or she should not be dismissed from the proceeding. The prohibition on ex parte messages becomes effective from the time that a notice of hearing is issued for the proceeding or at the time when a protest or a notice to intervene to oppose the Commission action has been filed, whichever is earlier.

An important point to be made about the operation of the ex parte regulations and the appearance of impropriety in general is that outside

88 Ibid.

89 Ibid. As noted below by attorney Edward Grenier, informal rulemakings consisting of notices of proposed rulemaking and submittal of comments by interested parties would not appear to come under this restriction.

90 See sections 385.2201(f) and 385.2201(g). Commissioner Stalon observed that the ex parte rules and the open meeting law limited the amount of contact that the FERC could have with other federal and state agencies. In its quasi-judicial role, the Commission could not "willfully cooperate" with other agencies and this hampered any effort by the FERC to develop a comprehensive view of the industries that it regulated. Formal proceedings at the FERC were the only "unambiguously legitimate forum" for communication between the Commission and other agencies. See "Stalon: Regulatory Framework Allows Little Federal/State Interplay," Inside F.E.R.C., May 13, 1985, p. 3.
parties are instrumental in policing the behavior of the Commission and putting the FERC or individual commissioners on the defensive in specific cases. A group may accuse a commissioner of having made ex parte contacts with a rival interest or request that a commissioner recuse himself or herself from a case because of conflict of interest.

C. M. Butler III, who was FERC Chair from 1981 to 1983, was a target of such accusations several times. For example, in a 1982 case involving the United Gas Pipe Line Company several customers of the pipeline asked Butler to recuse himself because he had previously been associated with the law firm representing United in the case. Butler refused, however, saying that there was "no legitimate basis for concern about bias or prejudgment." He had been a "salaried associate" with the firm about ten years previously but had not worked on any matters for United.

Edward J. Grenier, Jr., an attorney who has often represented the Process Gas Consumers Group (an industrial consumer group) before the

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91 For example, in December 1987 the consumer group Citizen/Labor Energy Coalition accused the Commission of ex parte contacts in a pipeline case. C/LEC said that representatives of Texas Eastern Transmission had illegally met with officials from the Office of General Counsel and the Office of Pipeline and Producer Regulation in an attempt to avoid a deadline on the pipeline’s open access plan. In response to a letter from Senator Howard Metzenbaum of Ohio asking about the charges, Chair Martha Hesse stated that FERC staff had met with representatives of Texas Eastern to discuss the pipeline’s compliance with various requirements of Order No. 500. Staff had "made no commitment" that Texas Eastern’s filings "would be acceptable to the commission." The meetings did not involve discussion of a pending contested case. See "C/LEC Urges Legislators to Probe FERC 'Wrongdoing and Impropriety,'" Inside F.E.R.C., December 28, 1987, pp. 2-3; and "Staff Plans to Submit Revised Ex Parte Communications Guidelines....," Inside F.E.R.C., March 21, 1988, p. 11.

FERC and in court, has written on how a group or client could be represented effectively in agency proceedings. At one point Grenier discussed the use of various strategies, including ex parte contacts, in agency informal rulemaking proceedings. As described above, informal rulemakings consist of agency notice to the public followed by receipt of written comments although hearings also may be held. He noted that ex parte contacts between outside parties and agency decision makers are generally not prohibited by the administrative procedures laws in this type of rulemaking except when it dealt with "competing claims by opposing persons to a valuable economic privilege." Ex parte contacts could thus be part of a broad strategy to represent the client effectively.

In describing their groups' relationships with the Commission, industry representatives interviewed for this research used various terms. Some said that the relationship was good or cordial while others said that it was formal or contentious or that it varied by issue. Interestingly, the one group that characterized the relation as rather hostile, the

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94 Ibid., p. 86. Grenier observed that lawyers tended to avoid ex parte contacts. However, in his opinion such avoidance was unnecessary and might violate the obligation of the attorney to represent the client as well as possible. The attorney should learn what the agency's limits on ex parte communications were and use them to the extent that they would be lawful and helpful to the client's case. See ibid., p. 90.

95 Ibid., pp. 86-87. By contrast, formal rulemakings are more adjudicatory in nature. They involve evidentiary hearings with receipt of evidence, cross examination of witnesses, recommended decisions by administrative law judges, and restrictions on ex parte communications. See ibid., p. 87.
Associated Gas Distributors, was also very actively challenging the FERC in court.

The representative of the predominantly pipeline group said that his group wanted to work with the Commission at every opportunity and that the relationship was one of respect and personal cordiality. On some occasions, his group and the FERC would be on the same side. At other times, they would be on opposite sides. The relationship was a "realistic" one between a representative of a regulated industry and the regulators.

According to the AGD counsel, the relationship of that group with the FERC had differed over the years but the relationship at the time of the interview (in summer 1988) was characterized by "antipathy" because the Commission was not sympathetic to distributors. Martha Hesse wanted to subject distributors to more market pressures feeling that they were the last bastion of monopoly. The AGD was very active and forceful and that did not help its relationship with the FERC. At that time, in the view of the attorney, the Commission was more sympathetic to producers and pipelines.

The AGA official characterized the general relationship between that group and the FERC as "pretty good" even though the AGA had not achieved all of its major goals. An attorney representing the Process Gas Consumers Group (PGC) said that the relationship between the FERC and the PGC was "formal" and "by the books." The group was well known to the FERC because it was active in many cases and took "principled positions from case to case." Its positions were long-term and did not vary from case to case. In Order No. 436 and in some other proceedings, the group had obtained "fairly good results from the Commission after sustained effort." There was no "inside track" because the PGC did not lobby the Commission intensively due to the ex parte rules.

In characterizing the relationship between producers and the FERC, an attorney representing producers observed that that segment of
the gas industry had been "a real unknown" at the Commission.96 Pipelines "walked the halls" but producers had not. Producers had not participated in pipeline rate cases to any great degree. Prices were prescribed by law and there was some participation in certificate and rulemaking procedures but there was no serious involvement in the regulatory process. The FERC did not have a major impact on producers' day to day operations. The Commission's decisions in open access and transportation had made more of an economic difference to producers, however, and so they were becoming more active.

Two other producer attorneys observed that the relationship between the FERC and producers varied from issue to issue and from producer to producer. Certain producers were "on a blacklist" while others were "on the fair haired list" and there were "a lot in between." Producers had adopted a pro-deregulatory position with respect to open access and that had "played well" among the commissioners who were grateful for the support of their policies. The Commission, however, did

96 In a news account from late 1984, it was observed that producers had traditionally been inactive before the FERC but that they wanted to be ready for a more active Commission after the NGPA mandated partial deregulation became effective in January 1985. Producers were preparing to ask the Commission to push for more transportation by pipelines. See "Producers Look More at FERC; Rulemaking Petition on Carriage in Works," Inside F.E.R.C., October 29, 1984, p. 1. By early 1986, producers had formed a new group with gas marketers, the Producer-Marketer Transportation Group, that was intervening in pipeline cases involving the implementation of Order No. 436. The group sought to insure that pipelines did not "perpetuate barriers to competition" and was trying to promote open access. See "Reflecting Producers' Growing Assertiveness in Pipeline Cases at FERC....," Inside F.E.R.C., March 24, 1986, pp. 7-8. A former FERC Chair remarked that the Commission has a history of independence. Pipelines had historically been more influential at the FERC than the other industry segments but producers and distributors also had become involved as the industry had become more competitive (thanks to Order No. 436 among other things). Thus, there was more pressure on the Commission. Independence was important.
not generally say in its rules that it agreed with producers on specific points. However, the attorneys felt that this was the case for all of the industry segments. No segment held sway with the Commission and no segment was in the dog house.

An attorney representing a large producer characterized his company's relationship with the FERC as formal. Company representatives would have an occasional meeting with the commissioners (approximately every five years) to present their views on the gas industry. Commission staff would be present in the meetings so that there would be no appearance of impropriety.

Recalling Ripley and Franklin's discussion of protective regulation, mentioned in chapter 1, as a kaleidoscope with parties coming and going as their own interests were involved, some observations can be made about interests and the FERC. The Commission is faced with well-organized interests that will be presenting their views forcefully to the FERC in rulemakings and other forums. These groups are more than willing to take the FERC to court if they do not win at these other stages.

As noted above, however, the interests do not always agree with each other. Thus, the Commission will usually have some interests supporting its position (or at least part of its position) in particular cases against other interests. The situation will not generally be FERC versus all of the interest groups. The disagreement among the industry segments was noted by Congressional Quarterly as a major reason for the failure of Congress to agree on gas legislation in the 1980s. The interest group picture facing the FERC, in short, will be kaleidoscopic and perhaps volatile as the groups confront each other in addition to confronting and/or trying to persuade the Commission.

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Conclusion

This chapter has included a brief overview of federal regulation of the natural gas industry. As can be seen from this discussion, the FERC faces a variety of external pressures as it exercises its authority under the Natural Gas Act and the Natural Gas Policy Act. The administration (White House and DOE), the Congress, the courts, and various interest groups all place demands on the Commission and expect it to act in certain ways. The Commissioners themselves and agency officials will have their own ideas about what the FERC ought to do as it shapes gas regulatory policy.

Table 2.5 below contains an overview of the major external actors facing the FERC in the gas policy subsystem (with the exception of the courts who would not be expected to have a natural gas policy agenda similar to those outlined in the table). The table summarizes some of the material in the above discussion with additional sources noted. The next chapter describes five instances in which the Commission clashed with some of those in its environment over certain policy issues.
The Reagan White House favored market forces over government regulation as the driving force for natural gas. White House appointments to FERC reflected this viewpoint.

The Department of Energy (DOE) was in favor of promoting competition in gas markets, supporting decontrol of gas production and nondiscriminatory open access to pipeline transportation. FERC is housed in DOE and the Department participated in some FERC rulemakings. FERC has a history of independence, however, and there were no major attempts to influence the FERC by DOE.

Congress had passed the Natural Gas Policy Act during the Carter administration, partially deregulating gas production, but was unable to enact a law mandating full decontrol during the Reagan administration. Congress was generally pleased with FERC natural gas policy during the Reagan term although parts of Order No. 436, the transportation policy and particularly the billing provisions, attracted opposition from individual members.

The Natural Gas Supply Association (NGSA) supported nondiscriminatory access to pipeline transportation for customers buying gas directly from producers instead of from pipelines. NGSA was in favor of complete decontrol of gas production. It opposed any major governmental effort on take-or-pay contract provisions believing that the parties involved could solve (and were solving) the problem themselves by renegotiating the contracts.

The Interstate Natural Gas Association of America (INGAA) was concerned about the changes that the FERC was forcing the industry to undertake (pipelines foregoing their role as gas merchant in favor of being gas transporter) but generally favored the idea of open access to pipeline facilities. INGAA wanted FERC to require producers to grant relief to pipelines from take-or-pay provisions (requiring pipes to take fuel or pay for it anyway) in return for producer access to pipelines.

Table 2.5: Major governmental and interest group actors in the FERC natural gas policymaking environment during the Reagan term.
The American Gas Association (AGA) agreed with INGAA on the need for take-or-pay relief and on the idea of conditioning producer access to transportation on producers granting such relief. AGA also was concerned about some proposals mandating that transportation should be mandatory instead of the voluntary program implemented by the FERC in Order No. 436.

The Associated Gas Distributors (AGD) supported nondiscriminatory transportation and was also concerned about take-or-pay costs being passed on to local distributors. AGD also felt that FERC did not take into consideration adequately local distributors' obligation to serve which was subject to state regulation.

The Process Gas Consumers Group (PGC) supported nondiscriminatory transportation and full decontrol of gas production. PGC felt that pipelines and local distributors had both acted as bottlenecks, limiting competition in the areas they served. FERC should offer incentives to local distributors to offer transportation services.

The Citizen/Labor Energy Coalition (C/LEC) was concerned about the possibility of gas shortages, their impact on residential consumers, and the ability of pipelines (as transporters only with no supplies of their own) to deal with shortages. C/LEC did not think that the FERC was implementing open access vigorously enough.

CHAPTER 3

THE COURT CASES

This chapter contains a chronology of the five court cases that are the subject of this study along with some brief observations on Commission implementation or evasion of each court order. The cases involve an assertion of authority by the Federal Energy Regulatory Commission (FERC) under either the Natural Gas Act (NGA) or the Natural Gas Policy Act (NGPA), the implementation of a new program by the Commission, the interpretation by the FERC of some provisions of the NGA or the NGPA, or a combination of more than one of these characteristics. In each instance, the Commission was told by the courts, usually the U.S. Court of Appeals for the District of Columbia, that its actions were wrong and could not be supported by the statute involved. The FERC was then left to respond to this setback.

The rulings examined in the analysis are, it is felt, adverse decisions of some importance. The degree of importance can be measured by whether a case was mentioned by certain specialized publications that are considered authorities in their fields. For the FERC, the main source consulted was the *Energy Law Journal*, published by the Federal Energy Bar Association. The Association consists of lawyers active in the area of federal energy law. The focus is on court decisions handed down during the Reagan administration although some of the policies may have originated before that time. The hope was that documents and individuals involved in disputes arising during those years would be easier to
locate than might be so for earlier years and litigation. A brief overview of the five cases, discussed roughly in chronological order, is presented next with the more extensive discussions following.

The first is *Mid-Louisiana Gas Company v. Federal Energy Regulatory Commission*, 664 F.2d 530 (5th Cir. 1981). In this case, the Court of Appeals for the Fifth Circuit vacated two FERC orders in which the Commission had sought to set the maximum lawful price for natural gas transferred from the production division to the transportation division of a pipeline company. The court ruled that such transfers were "first sales" of the gas, as defined by the Natural Gas Policy Act, and that the FERC should use the maximum lawful prices set out in the Act instead of setting the prices itself.

The *Mid-Louisiana* decision was partially affirmed by the U.S. Supreme Court in *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company*, 463 U.S. 319 (1983). The Court agreed that the FERC had incorrectly excluded the intracorporate transfers of gas from the "first sale" category. However, the Justices remanded the case to the Commission, stating that the Congress intended to give the FERC discretion to decide whether the gas should be considered a first sale at the intracorporate transfer stage or at the later, downstream, stage of transfer between the pipeline and a customer.

The second case is *Interstate Natural Gas Association of America v. Federal Energy Regulatory Commission*, 716 F.2d 1 (D.C. Cir. 1983), cert. denied at 465 U.S. 1108 (1984). In this decision, the U.S. Court of Appeals for the District of Columbia vacated a rule of the FERC that had changed the way in which the energy content of gas was measured for the wellhead pricing purposes of the Natural Gas Policy Act. The FERC had shifted from a system of measuring the Btu content of gas saturated with water vapor at a set temperature and pressure (the
"wet" rule) to a system of measuring the Btu content of the gas as it was when actually delivered for sale to the pipelines. This second approach was labelled the "dry" rule because the gas, when delivered, contained much less water vapor than the levels specified in the old approach. The court ruled that this shift in measurement systems violated the pricing scheme embodied in the NGPA.

The third case consists of three rulings: *Maryland People's Counsel v. Federal Energy Regulatory Commission*, 761 F.2d 768 (D.C. Cir. 1985), *Maryland People's Counsel v. Federal Energy Regulatory Commission*, 761 F.2d 780 (D.C. Cir. 1985), and *Maryland People's Counsel v. Federal Energy Regulatory Commission*, 768 F.2d 450 (D.C. Cir. 1985). In these companion rulings, the U.S. Court of Appeals for the District of Columbia struck down special marketing and transportation programs approved by the FERC. The programs were designed to keep noncaptive, mainly large industrial, customers with the capability to switch fuel on a pipeline's system. Captive customers, generally residential customers who did not have any fuel switching capability, were excluded from the programs. The court ruled that the FERC had not reasonably assessed whether the special marketing program would benefit all of the pipeline's ratepayers. The FERC had also not evaluated the anticompetitive consequences of the transportation program.

The fourth case is *Northern Natural Gas Company v. Federal Energy Regulatory Commission*, 827 F.2d 779 (D.C. Cir. 1987). The U.S. Court of Appeals for the District of Columbia vacated part of a Commission order approving a gas marketing program for Northern Natural. In permitting the operation of the program of pricing gas flexibly to compete with alternative fuels, the FERC had imposed the requirement that customers of Northern who were not eligible to take
part in and receive the benefits from the program should receive revenues that Northern Natural earned from the sales. The D.C. Court, relying on and reaffirming one of its previous decisions, said that the Commission's stipulation was a modification of previously approved rates. The Commission would have to use a section 5 (NGA) proceeding to change such rates and not a section 7 certification procedure.

The fifth case is *Consolidated Edison v. Federal Energy Regulatory Commission*, 823 F.2d 630 (D.C. Cir. 1987). The U.S. Court of Appeals for the District of Columbia vacated a Commission order establishing a more lenient market-based approach to abandonment of service by a producer to a pipeline. The judges found that the policy was based on faulty logic and could harm the position of pipelines in their negotiations with producers concerning uneconomic contracts that required the pipelines to take gas that they could not sell.

**The Mid-Louisiana Case**

The definition of "first sale" used by the FERC for purposes of pricing gas according to the maximum lawful prices mandated by the Natural Gas Policy Act was a major point of contention here. More specifically, this case was concerned with the Commission's decisions on whether or not intracorporate transfers of gas from a company's production operations to its pipeline division (i.e. pipeline producers) qualified for NGPA first sale treatment or for some other treatment, such as Natural Gas Act traditional public utility cost of service regulation. Allowing the NGPA price would enable the pipelines to collect more for their product than would the cost of service based price. Thus, this case was very important for those carriers.
Section 2(21) of the Natural Gas Policy Act of 1978 defined "first sale" in the following manner.

(21) First Sale.--
(A) General Rule.--The term "first sale" means any sale of any volume of natural gas--
(i) to any interstate pipeline or intrastate pipeline;
(ii) to any local distribution company;
(iii) to any person for use by such person;
(iv) which precedes any sale described in clauses (i), (ii), or (iii); and
(v) which precedes or follows any sale described in clauses (i), (ii), (iii), or (iv) and is defined by the Commission as a first sale in order to prevent circumvention of any maximum lawful price established under this Act.

(B) Certain Sales Not Included.--Clauses (i), (ii), (iii), or (iv) of subparagraph (A) shall not include the sale of any volume of natural gas by any interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof, unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof.¹

The FERC issued interim regulations to implement this section along with the rest of the statute, effective December 1, 1978.²

The Commission decided not to treat the question of intracorporate transfers of gas at that time. Such transactions by interstate

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pipelines would continue to receive the same treatment under the NGA until the FERC decided otherwise.

Almost one year later, in November 1979, the Commission issued Order No. 58. The Commissioners, in response to comments, refused to extend first sale treatment to intracorporate transactions. They argued that NGPA prices would then be applied to a company's bookkeeping and accounting entries instead of to actual sales of gas. Such an extension of NGPA pricing would then have to be applied to all companies producing their own natural gas and the Commission noted that industrial customers had argued that that would be undesirable.

At the same time that it issued Order No. 58, the FERC also issued a notice of proposed rulemaking (NOPR) on the pricing of pipeline and affiliate gas production under the Natural Gas Act. Such gas would not generally have qualified for first sale pricing under the NGPA. The Commission proposed to allow interstate pipelines and their affiliates to use NGPA maximum lawful prices for gas that they produced which had received area or national rates under the Natural Gas Act prior to the passage of the NGPA.

3 See Final Rule Governing the Maximum Lawful Price for Pipeline, Distributor or Affiliate Production; Docket No. RM80-7; Final Regulations; Order No. 58; Issued November 14, 1979, 44 Fed. Reg. 66,577 (November 20, 1979). In addition to the points discussed in the text, the Commission also stated that all sales by an affiliate of a pipeline or a distributor were to be considered first sales if the affiliate was not itself a pipeline or distributor unless the Commission decided otherwise. Transactions between an interstate pipeline and its affiliate were not considered sales if the transactions would not have been treated as such under the Natural Gas Act.

This policy, however, was to apply to pipeline production from wells drilled after 1972 on property leased after October 7, 1969. The Commission had allowed such gas to receive area or national rates so that the prices paid for it would be comparable to the prices received by independent producers for their gas. Pipeline production from wells drilled before 1972 on leases acquired on or before October 7, 1969 would continue to be priced on the basis of cost of service regulation. Such regulation was intended to recover the cost of production for the pipeline. Pricing of the gas produced from those older wells had not been intended to be comparable to prices received by independent producers.

The Commission proceeded to put this policy into effect by issuing Order No. 98 on August 4, 1980.\(^5\) NGPA pricing would apply to gas

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\(^5\) See Pricing of Pipeline Production under the Natural Gas Act; Final Rule; Docket No. RM80-6; Order No. 98; Issued August 4, 1980, 45 Fed. Reg. 53,091 (August 11, 1980). The Commission explained that in the 1960s and 1970s the Federal Power Commission (FPC), predecessor agency to the FERC, had moved from cost of service ratemaking to rates based on average costs set for an entire producing area. This shift was made for sales by independent producers first and then for sales by pipeline producers. Gas supplies were diminishing and the Commission felt that the new rates would encourage production. In taking the step of allowing the area rates for pipeline producers, the FPC also sought parity of treatment for independent producers and pipeline producers. Gas produced by a pipeline or its affiliate from wells on property leased after October 7, 1969 qualified for that areawide pricing.

When the Commission shifted from area to nationwide rates in the early 1970s, it reaffirmed the policy of pricing parity between independent and pipeline producers. The FPC requirement for nationwide rates to apply was that a well must have been drilled on or after January 1, 1973, regardless of the date that the property was leased. By the time of the enactment of the Natural Gas Policy Act in 1978, area or nationwide rates applied to most pipeline produced gas except most production from pre-1973 wells located on pre-October 8, 1969 leased property. Other wells had been granted cost of service treatment by the FPC because of (continued...)
produced by a pipeline or its affiliate from property leased after October 7, 1969 or from wells started on or after January 1, 1973. The new law's pricing would also apply to gas to which the Commission had applied area or nationwide rate treatment before December 1, 1978, the effective date of the NGPA. Cost of service treatment would continue to be applied to gas produced by a pipeline or its affiliate from leases acquired before October 7, 1969 and from wells drilled before January 1, 1973. Cost of service pricing would also be used for gas produced from property leased before November 15, 1979 if that type of pricing had ever been applied to it.

On October 3, 1980, the FERC issued Order No. 102, denying rehearing of Order Nos. 58 and 98 and clarifying the latter rule. The Commissioners explained further why the NGPA incentive maximum lawful pricing would not be applied to pipeline production previously subject to cost of service treatment. The FERC decided that

Such pipelines have already enjoyed the benefits of a certain [i.e. guaranteed] recovery of and return on the costs of

5(...continued)
special circumstances.

The Commission (now the FERC) decided to retain pricing parity between independent and pipeline producers after the passage of the NGPA. Parity would apply to those pipeline producers that had been receiving the area or nationwide rates. The Commissioners decided, however, that cost of service regulation would continue to apply for gas from wells drilled before 1973 on property leased before October 8, 1969. The Commission believed that that type of rate would recover adequately for the pipelines the costs of production from those wells.

6 See Natural Gas; Pricing of Pipeline and Affiliate Production under the Natural Gas Act; Order Denying Rehearing of Order No. 58 and Order No. 98 and Clarifying Order No. 98; Docket Nos. RM80-7 and RM80-6; Order No. 102; Issued October 3, 1980, 45 Fed. Reg. 67,083 (October 9, 1980).
production, and ... their customers, who have borne the risks of this investment in the early years of exploration and development, should have an opportunity to receive the price benefits of cost-of-service treatment for gas produced as a result of the expenditures.  

The Commissioners then proceeded to discuss the arguments of the petitioners seeking rehearing of Order Nos. 58 and 98. Two of the parties arguing against the orders, who were also the petitioners in the subsequent court case, were Mid-Louisiana Gas Company and Consolidated Gas Supply Corporation.

Mid-Louisiana, Consolidated and other parties argued that the FERC could, for purposes of first sale treatment, impute a sale at the wellhead where the pipeline would take the gas that it produced into its transmission system. Mid-Louisiana stated that the delivery into the pipeline of gas that it produced was a transfer for value and thus a sale.

The Commission responded that it had not treated the transfer of pipeline produced gas into the corporation's transmission system as a sale under the Natural Gas Act. The transfers were not governed by any contract and no certificates were issued under the NGA to allow them to proceed. The NGPA did not make it necessary for the FERC to change its policy.

Consolidated and several other parties also argued against the Commission's decision in Order No. 98 to allow first sale treatment to pipeline produced gas previously priced under the area or nationwide pricing system and continuing cost of service regulation for other pipeline

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7 Ibid., pp. 67,084-67,085. The implication here is that cost-of-service treatment would result in lower rates for consumers than would the NGPA maximum lawful prices. In another subsequent order, the Commission stated that NGPA rates would be higher than cost of service although on rare occasions the reverse could be true.
produced gas. The parties claimed that the FERC had exercised its authority improperly to assert jurisdiction over pipeline production. The Commission response was that section 2(21)(B) did not require mixed volume sales (gas produced by the pipeline mixed with gas produced by other sources) to be treated as first sales and had maintained FERC authority to regulate such sales under the Natural Gas Act.

Mid-Louisiana v. FERC

After failing in this attempt to have Order Nos. 58 and 98 modified by the Commission, Mid-Louisiana and Consolidated and other parties went to the U.S. Court of Appeals for the Fifth Circuit. A three-judge panel decided the case on December 23, 1981.®

In reviewing Order No. 58, the court remarked that the Commission's interpretation of section 2(21)(B) would "effectively read the second part of this subsection out of the NGPA."® The first part of the section said that a first sale would not include a sale by an interstate pipeline, an intrastate pipeline, a local distributor, or an affiliate or any one of these. The second part, to which the court referred, added to that prohibition, however, "unless such sale is attributable to volumes of natural gas produced by such interstate pipeline, intrastate pipeline, or local distribution company, or any affiliate thereof."®

Taking the "unless" clause away would deny first sale NGPA pricing to all gas produced by a pipeline. The court stated that nothing in the NGPA suggested that such a result was intended. On the contrary, the


® Ibid., p. 535.

"unless" clause would only have meaning if it was interpreted so as to allow first sale treatment to gas produced by a pipeline.

Pipeline producers deserved the encouragement of NGPA prices no less than other producers in working to achieve the goal of increased gas production. The Commission argued that it was encouraging production through Order No. 98 by allowing NGPA pricing for some pipeline production. The court responded, however, that the FERC should not alter the statutory scheme. In addition, "the fact that the agency gives back all or part of what it takes from the law's grant in no way justifies departure from the congressional purpose in the first instance."

The judges also asserted that the FERC could have avoided the problems that it sought to resolve through Order No. 58 if it had equated the intracorporate transfer of gas from a company's production division to its transmission division with the acquisition of gas by the pipeline from an independent producer. The legislative history of the NGPA suggested that Congress intended the sale by the producer of the gas to be the first sale. In this context, that would be the transfer from the production division to the transmission division of the pipeline.

Thus, the panel vacated Order No. 58, holding that Congress intended for any volumes attributable to an interstate pipeline, intrastate pipeline, local distributor, or an affiliate of any one of these to receive first sale status under the NGPA and for the intracorporate transfer to be that first sale. The judges also decided to vacate Order No. 98, "because we hold that the Commission lacked authority to set prices for interstate pipeline production under the NGA...."

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12 Ibid., p. 538.
The Fifth Circuit denied rehearing of this decision on February 5, 1982.\textsuperscript{13} The case was then appealed by the FERC and others to the U.S. Supreme Court which decided it as \textit{Public Service Commission of the State of New York v. Mid-Louisiana Gas Company et al.} on June 28, 1983.\textsuperscript{14}

The Justices stated that the pipelines sought first sale treatment for either the intracorporate transfer of gas from production to transmission division or the downstream transfer of mixed gas from the pipeline to a customer. In their view, Congress had authorized the FERC to treat either transfer as a first sale and not to reject both possibilities. The Commission thus had the authority to treat either transfer as a first sale.

The Justices then reviewed the history of federal natural gas regulation up to the NGPA, and then summarized the statute itself. They remarked that "given such a comprehensive scheme," Congress would certainly have identified any "significant source of production" that it had wanted to be excluded from the statutory pricing framework. However, "nowhere in the NGPA do we find any expression of a desire to exclude pipeline production."\textsuperscript{15}

Noting the first sale exemption of section 2(21)(B) which mentioned pipeline production and other provisions of the NGPA in which such production was also mentioned, the Court concluded that pipeline production was to be covered by the NGPA. The Justices stated that "the

\textsuperscript{13} Ibid., p. 530. The opinion states that both rehearing and rehearing \textit{en banc} were denied as of that date.


\textsuperscript{15} Ibid., pp. 336-337.
Court of Appeals correctly concluded that Congress intended pipeline production to receive first sale pricing.\textsuperscript{16} The Court concluded that the Commission's policy was "contrary to the history, structure, and basic philosophy of the NGPA."\textsuperscript{17} The Justices agreed with the Fifth Circuit panel that the FERC should not have excluded pipeline production from NGPA first sale pricing. They differed with the Court of Appeals, however, by allowing the Commission to decide whether first sale pricing should be used at the intracorporate transfer from production to transmission division (as the Fifth Circuit had ordered) or the downstream transfer from the pipeline to a customer. The Court remanded the case back to the FERC for further proceedings.

**Commission Response**

The FERC issued a notice of proposed rulemaking on December 28, 1983, six months after the Supreme Court's decision.\textsuperscript{18} The Commission proposed to designate as a first sale the intracorporate transfer of gas from the production division to the transmission division of an interstate pipeline company. The Commission also proposed to define the sale as occurring at the gas wellhead. The FERC believed that this definition was necessary as the transaction was usually only a paper transaction between the two divisions.

\textsuperscript{16} Ibid., p. 338.

\textsuperscript{17} Ibid., p. 342.

The Commission intended to apply the NGPA affiliated entities test to the transactions to determine whether preferential treatment was being given by the pipeline to its production division. The affiliated entities rule said that a price paid for gas by an interstate pipeline to its affiliate would be considered just and reasonable and entitled to recovery from customers only if certain conditions were met. Those stipulations were first, that the price did not exceed a sum paid in a comparable sale by the pipeline to a nonaffiliated seller or second, that the price was not greater than that used in a sale where neither the buyer nor the seller were associated with the pipeline.

The Commission proposed to include any sales by pipelines (interstate or intrastate), affiliates, and distributors in first sale pricing. Sales by affiliates had been given first sale treatment in Order No. 58. The FERC felt that the Court of Appeals had not intended to vacate that part of the order and so it proposed a similar regulation to that found in Order No. 58.

The FERC proceeded to issue Order No. 391 on August 22, 1984.¹⁹ In this order the Commission implemented the major parts of its proposed rule including the designation as a first sale of the intracorporate transfer of gas from a pipeline’s production division to its transmission division. The designation of sales by affiliates as first sales was also included as proposed in the NOPR. The FERC also reaffirmed two other points from the proposed rule: the decision to use the NGPA affiliated entities test in order to determine the reasonableness of prices paid in the intracorporate sales and the designation of the wellhead as the transfer point of the gas.

The Commission decided that pipelines would be allowed to use cost-of-service pricing if they had been using that method previously. However, the Commissioners said that they would review any prices resulting from that method if they were higher than the NGPA price that would have otherwise applied.

Other Commission Actions

The FERC response to the court included several other actions constituting both implementation and evasion that should be noted here. For example, after the Fifth Circuit ruling the Commissioners decided to allow pipelines to file to pass through to their customers the increased gas costs resulting from the higher NGPA pricing of their own production. However, they also decided by a majority vote to appeal the case to the Supreme Court. In addition the Commission made other decisions limiting the ability of pipelines to take advantage of the Mid-Louisiana ruling. For example, in one instance the FERC ruled that a pipeline could not collect the higher prices retroactively for gas produced from December 1978 to May 31, 1982 because it was bound by contracts that had set lower prices for that time period.

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20 Ibid., p. 33,858.

Another Commission attempt to limit a pipeline's ability to claim the higher NGPA prices resulted in a court challenge and a remand to the FERC. Ironically the pipeline involved was once again Mid-Louisiana. This sequence of events is interesting because it shows the Commission attempting to limit the impact of the Mid-Louisiana ruling and the ability of the prime litigant (and a major beneficiary) of that ruling to take immediate advantage of the court decision. The fact that the decision was being appealed to the Supreme Court at the time might have been one motivation for the FERC. What is important here is that it took another court decision before the FERC allowed Mid-La to recover NGPA prices to the fullest extent possible.

Soon after the Fifth Circuit ruling had gone into effect on March 2, 1982 (but before the Supreme Court had decided the case), Mid-Louisiana had filed with the FERC to collect NGPA prices for its pipeline produced gas through its purchased gas adjustment clause. Mid-La wanted the Commission to waive some of its regulations and allow it to collect the higher prices immediately. The Commission decided to suspend the filing for five months, until August 2, 1982. At that point, Mid-La could begin to collect the NGPA rates, subject to refund.22

Mid-Louisiana filed for rehearing of the Commission's five month suspension, arguing that it was contrary to the Fifth Circuit's decision. The Commissioners responded in an order issued in November 1982, asserting that "while we do not question our obligation to abide by the [Fifth Circuit] mandate, the court did not have before it the issue of when a pipeline might collect increased pipeline rates that it otherwise was entitled to receive." The FERC had the discretion to determine the

22 See Mid-Louisiana Gas Company, Docket No. RP82-51-000; Order Accepting for Filing and Suspending Proposed Tariff Sheets Subject to Refund and to Conditions, 19 FERC para. 61,016 (Issued April 8, 1982).
procedures for implementing the court's decision and would, consistent with Commission regulations and the NGA, determine when the increased pipeline rates could be collected.\(^{23}\)

The Commissioners noted that in April 1981 they had approved a settlement setting rates, terms, and other conditions for Mid-La until January 1, 1983. They stated that "it is well established that what is not specifically stated in the settlement agreement cannot thereafter be read into it."\(^{24}\) Once the FERC had approved a settlement and found it to be in the public interest, it was also bound by its terms along with the parties to the agreement. The Commissioners observed that after examining the Mid-La settlement they found only one reference to the pipeline production issue, stating that Mid-La's production would be priced at NGPA rates or cost of service rates. While the agreement had provided for cost of service pricing, Mid-La had not reserved the right to reprice its production depending on the outcome of the then pending court case

\(^{23}\) See Mid-Louisiana Gas Company, Docket No. RP82-51-000; Order Denying Rehearing, Vacating Hearing and Requiring Refund, 21 FERC para. 61,072 (Issued November 12, 1982) at p. 61,249. Reference omitted. Note the almost defiant language and the attempt to reassert Commission authority.

\(^{24}\) Ibid., p. 61,250. Reference omitted. Pipeline settlements are negotiated dispositions of rate cases or other matters. In a settlement, the parties disputing in a rate case or other proceeding would negotiate and compromise their differences. According to the chief administrative law judge of the FERC, "a settlement often represents a splitting of differences in order to achieve a workable basis that each party can live with." A party rarely gained everything that it originally sought in the case. The agreement would then have to be certified by the administrative law judge presiding over the case. The Commission must determine that the settlement is in the public interest and can modify it before approving it. See "The Settlement: 'Splitting of the Differences,'" FERC Monitor, June 27, 1983, pp. 1, 3, 11. As mentioned below in the section on the Maryland People's Counsel case, settlements were also used in the implementation of Order No. 436.
and thus could not do so during the life of the agreement. The Commissioners dismissed Mid-Louisiana's March 1982 filing although they also stated that the pipeline could refile after the settlement expired. Mid-La was also ordered to refund with interest the NGPA rates that it had been collecting since August 2, 1982.²⁵

Mid-Louisiana went back to the Fifth Circuit, arguing that the Commission's interpretation of the settlement disregarded the court's ruling. The pipeline contended that the language of the settlement specifying that the fuel it produced would be priced by cost of service or NGPA methods preserved its right to use the NGPA method. In addition, the settlement provided that Mid-Louisiana could make purchased gas adjustment or other filings with the Commission. Mid-La argued that this provision allowed it to file to collect NGPA prices.²⁶

The judges issued their order in January 1986. They stated that the provisions of the settlement cited by Mid-Louisiana were not specific enough to uphold the pipeline's right to reprice its production according to the NGPA. However, the court was also not persuaded by the Commission's argument that the pipeline had given up its right to reprice. That issue was not present in the settlement negotiations and the document was not intended to cover all topics. Mid-La had agreed to cost of service pricing in the settlement because that was Commission policy at the time. The fact that Mid-Louisiana had not reserved the right to reprice its production did not mean that it had surrendered that right. The Commission was in error when it prevented the pipeline from recovering the NGPA prices during the period of August 2, 1982 (when the five

²⁵ Ibid., pp. 61,251-61,252.

²⁶ See Mid Louisiana Gas Company v. Federal Energy Regulatory Commission, 780 F.2d 1238 (5th Cir. 1986) at 1243-1244.
month suspension ended) to January 1, 1983. The court reversed and remanded the order to the FERC.27

The Commission issued its order on remand in June 1986. Mid-La would be allowed to file to collect the NGPA prices for its pipeline production for August 2, 1982 to January 1, 1983. The Commissioners also stated that Mid-Louisiana would be allowed to file to collect the higher prices retroactively for previous periods.28

27 Ibid., pp. 1244-1246, 1248. The opinion contains some data that makes clear the economic incentives that Mid-La had in pursuing this case. The judges noted that Mid-La produced forty percent of the gas that it sold and that the pipeline had estimated that the difference between NGPA and cost of service pricing for its gas amounted to almost $9 million for the period covered by the settlement. See ibid., pp. 1239 and 1245.

28 See Mid-Louisiana Gas Company, Docket No. RP82-51-005; Order on Remand, 35 FERC para. 61,275 (Issued June 3, 1986). The Commission may have mentioned the retroactive collection of NGPA prices because the court, in reversing the Commission order, did so without prejudice to Mid-La seeking recovery of NGPA prices back to the effective date of the statute (December 1, 1978). See Mid-La v. FERC, 780 F.2d at 1248. Soon thereafter, in August 1986, the Commission issued an order on a request from Gulf States Utilities, a customer of Mid-Louisiana. In this order, the Commission clarified that it had not ruled on the merits of any claim by Mid-Louisiana to NGPA prices. It had only said that the pipeline could file to collect the higher rates and then the merits of the filing would be determined. See Mid-Louisiana Gas Company, Docket No. RP82-51-006; Order Granting Clarification, 36 FERC para. 61,167 (Issued August 4, 1986).

The collection by Mid-Louisiana of NGPA prices for prior years involved an additional year of filings by the pipeline and rulings by the Commission. In July 1986, Mid-Louisiana filed with the FERC to collect retroactively the NGPA prices back to December 1978. Mid-La proposed to do this by splitting the time between the statute’s effective date and the end of 1982 into three periods. For period I, covering December 1, 1978 through January 31, 1982, the pipeline intended to bill its customers for approximately $41.2 million. For period II, covering February 1, 1982 through August 1, 1982, Mid-La intended to bill its customers for over
Subsequent Events: The *Phillips Case*

The FERC issued Order No. 391-A on April 10, 1985. This order included clarification of some of the provisions of Order No. 391 and also a denial of rehearing of that order. The Commissioners stated that only pipelines that had been using cost-of-service pricing because of arrangements previously approved by the FERC could continue to use it. The Commission did not want other pipelines that were not using cost-of-service pricing to switch to it in order to avoid market pressures.29

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28(...continued)

$4.3 million. Both of these periods' prices were to be covered in monthly bills to customers over five years. Period III prices, covering the remainder of 1982 and amounting to over $3.6 million, were to be recovered through three semiannual purchased gas adjustment filings. The Commission rejected the direct billing approach, saying that FERC policy had been to require passing through such repricing costs in the purchased gas adjustment. The Commissioners said that the period II costs could be recovered through the purchased gas adjustment along with the period III costs. Mid-La could refile at a later time to recover the period I costs through the purchased gas adjustment. The issue was apparently settled when the Commission approved a settlement for Mid-La in July 1987. Among its terms was a provision allowing the pipeline to collect retroactively $17.5 million in NGPA prices over a three year period. See Mid-Louisiana Gas Company, Docket Nos. TA86-2-15-000, TA86-2-15-001 (PGA86-2 and IPR86-2) and RP86-138-000; Order Accepting for Filing and Suspending Proposed Tariff Sheets Subject to Refund and Conditions, Granting Waiver and Denying Requests for Hearing, 36 FERC para. 61,194 (Issued July 31, 1986) at pp. 61,491 and 61,492-61,494; and Mid Louisiana Gas Company, Docket Nos. RP86-69-000, TA86-2-15-000, et al., RP82-51-000, et al., RP86-138-000, and GP82-31-000; Letter Order, 40 FERC para. 61,085 (Issued July 23, 1987) at p. 61,232.

29 See First Sales of Pipeline Production under Section 2(21) of the Natural Gas Policy Act of 1978; Docket Nos. RM83-72-001-RM83-72-009; First Sales by Affiliates; Docket Nos. RM82-16-001-RM82-16-009; Order Denying Rehearing and Clarifying Final Rule; Order No. 391-A, 31 FERC para. 61,036 (Issued April 10, 1985). Note that with the passage of (continued...)

165
The Commission also dismissed a request for rehearing from Phillips Petroleum Company and Phillips Oil Company. Phillips, a gas consumer, had objected to the FERC decision in Order No. 391 to allow pipeline production previously priced under cost of service regulation to collect the same NGPA maximum lawful prices as independent producers. The petroleum company claimed that the Commission had set a separate just and reasonable cost of service rate for pipeline production. The cost of service rates would be lower than the rates allowed for independent producers or for pipeline producers who had been collecting area or national rates.

The Commission rejected the Phillips argument, stating that the Mid-Louisiana decision required parity between independent and pipeline producers. Parity required allowing pipeline producers to receive NGPA ceiling prices.\textsuperscript{29}

Phillips appealed to the U.S. Court of Appeals for the D.C. Circuit which ruled in June 1986. The court said that the FERC had erred in its interpretation of the Supreme Court's decision. The judges said that the Supreme Court had held that the NGPA applied to the intracorporate transfer of gas but did not mandate the Commission's interpretation of parity between independent and pipeline producers.\textsuperscript{31}

In the view of the three-judge panel, the Supreme Court had assumed that the NGPA would freeze pipeline prices at the old cost of service level and not at the levels applicable to the independent

\textsuperscript{29}(...continued)

\textsuperscript{30} Ibid., pp. 61,065-61,066.

producers. As evidence of this reasoning, the judges cited the Court’s discussion of an FERC argument in the *Mid-Louisiana* case that pipeline producers would enjoy a windfall if their sales received the NGPA prices. The Justices had replied that this windfall was not possible, noting that the Commission’s argument applied only to gas receiving cost of service treatment at the time of the enactment of the NGPA. Section 104 of the Act had specified that such gas would receive the old NGA cost of service rate with an increase for inflation. Thus, there would be no windfall.\(^\text{32}\)

The D.C. Court felt that the Supreme Court, in rejecting the windfall argument, believed that the FERC would price pipeline production at its old rate and not at the same rate as gas produced by independent producers. However, the judges noted that the Supreme Court made this observation in passing. Thus, the High Court’s decision did not require the interpretation desired by Phillips but it also did not require the Commission’s interpretation of pricing parity.

The judges did not express their own interpretation of the NGPA section and sought only to note "the complex task forsaken by FERC when it incorrectly concluded that it was bound by *Mid-Louisiana.****

The panel remanded the case to the FERC for it to justify its position or to do otherwise "but FERC *may not* assume that any particular construction is mandated by *Mid-Louisiana.****

The Commission issued Order No. 391-B in August 1987, reaffirming the position that pipeline production previously subject to cost of service regulation was now subject to the same NGPA ceiling prices as

\(^{32}\) Ibid., p. 1170. The discussion in the *Mid-Louisiana* opinion of the Supreme Court is from 463 U.S. at 341-342.

\(^{33}\) Ibid., p. 1172. Emphasis in the original.
independent producers. NGPA section 104 had mandated that the applicable ceiling price for gas dedicated to interstate commerce on April 20, 1977 (the date when the NGPA was introduced in Congress) would be the just and reasonable rate established by the Commission for that gas on that date. The Commissioners concluded that the pre-NGPA cost of service regulation of pipeline production did not establish just and reasonable rates. No unit rates per thousand cubic feet of gas or per million British Thermal Units had been calculated. The only rates actually established by the Commission at that time were the national rates set for independent producers. Thus, the Congress intended that the rates established for independent producers were to be applied to pipeline produced gas and the NGPA section 104 rates were to be the same for both pipeline and independent producers.

Some preliminary observations should be made at this point on the Mid-Louisiana case in terms of the implementation-evasion continuum discussed in Chapter 1. The Commission exhibited both types of behavior, implementation and evasion, during the course of this case. The act of appealing the circuit court decision to the Supreme Court represents a sort of defiance of that mandate and an attempt to evade its full ramifications. At the same time as it was appealing to the High Court (as described more fully in Chapter 4 below) the Commission allowed pipelines to begin to file to collect the higher prices allowed by the appeals court decision (implementation). However the FERC did not allow pipeline recovery of those increased revenues in some instances (partial implementation or evasion). After the Supreme Court ruling, there appears to have been substantial compliance and implementation. In the

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34 See First Sales of Pipeline Production under Section 2(21) of the Natural Gas Policy Act of 1978; Docket No. RM83-72-010; First Sales by Affiliates; Docket No. RM82-16-010; Order No. 391-B; Order on Remand, 40 FERC para. 61,174 (Issued August 10, 1987).
Phillips episode, the FERC avoided any potential damage merely by reaffirming the policy that it was implementing after the Supreme Court order.

The INGAA "Wet" vs. "Dry" Rule Case

This case involved a dispute over the method used to measure the energy content of gas sold by producers to pipelines. For years, the FERC and its predecessor, the Federal Power Commission, had specified the use of the so-called "wet" rule. However, with the passage of the Natural Gas Policy Act in 1978, the Commission decided to switch to a new standard. As less water vapor was allowed in the gas under this new standard, the rule promulgating it was known as the "dry" rule.

The importance of this dispute derived from the fact that the NGPA framework set maximum allowable prices for gas on the basis of the fuel's energy content (dollars per millions of British Thermal Units (Btu)). The two different standards resulted in different measurements of the Btu content of the gas, a difference that translated into over a billion dollars of payments (on a national scale over the several years that this dispute transpired) that pipelines might or might not have owed to producers depending on which standard was used. Producers pushed for the dry or as delivered rule, arguing that the wet rule understated the amount of fuel actually delivered. Thus, they were deprived of revenues to which they were entitled. Pipelines argued for continuation of the standard or wet rule.

FERC Policy Decisions

As mentioned above, the "wet" rule was the standard used to measure the Btu content of gas for a number of years. The FPC noted in
a policy statement in May 1961 that it was considering the adoption of the standard. An opinion issued by the Commission in June 1965 contained a requirement that the standard be used.  


Sec. 2.60 Standards to be considered in determining independent producer's gas to be of "pipeline quality."
(a) "Pipeline quality gas" shall be natural gas which when measured at 14.73 psia [pounds per square inch of air] at 60 degrees F.:
   (1) Shall have a heating value of not less than one thousand (1,000) Btu per cubic foot when saturated with water vapor ...;
   (2) Shall contain not more than seven (7) pounds of entrained water per one million (1,000,000) cubic feet;

In the 1965 opinion, the Commission ordered that:

The Btu content of the gas used in computing the price adjustments approved herein shall be the number of British thermal units produced by the combustion, at constant pressure, of the amount of the gas which would occupy a volume of 1 cubic foot at a temperature of 60 [degrees] F. if saturated with water vapor and under a pressure equivalent to that of 30 inches of mercury at 32 [degrees] F. and under standard gravitational force ... with air of the same temperature and pressure as the gas, when the products of combustion are cooled to the initial temperature of gas and air and when the water formed by combustion is condensed to the liquid state.

See Opinion No. 464; Texaco Inc., G-8087, G-12710 et al., 33 FPC 1228 (1965) at p. 1238. As these quotations show, the "wet" rule allowed for more water vapor because it provided for a standard laboratory condition under which the gas would be "saturated with water vapor." The gas that producers delivered to the pipelines might have and usually did have less water vapor than specified in the standard condition.
In December 1978, the FERC issued interim regulations to implement the Natural Gas Policy Act, incorporating the wet standard of Btu measurement. The Commission issued the interim regulation as a final rule, Order No. 93, in July 1980. However, the FERC noted a comment that the rule, in basing Btu content on a "saturated with water vapor" basis instead of the actual water vapor content of the gas when delivered, would insufficiently compensate sellers who would be delivering more Btu's than the amount for which they would be paid. The FERC responded that the commenters were incorrect. The "wet" rule was a standard test for expressing the Btu content of a cubic foot of gas under certain conditions.

The Commission is aware that the water vapor content or pressure of the gas when tested may be different than described in this standard, and may also be different than the conditions that obtain when the gas is delivered. Therefore, the results obtained under test conditions, be they those in the rule or others, must be converted to figures that reflect the actual condition of the gas on delivery in order to properly price the gas.

While the "as delivered" language was not made an actual part of the standard in Order No. 93, the language used by the FERC showed that it had shifted from the standard condition or "wet" rule to the as delivered or "dry" rule for purposes of pricing gas in first sales.

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In April 1981, the FERC issued Order No. 93-A clarifying and denying rehearing of Order No. 93.\footnote{See Rules Generally Applicable to Regulated Sales of Natural Gas; Order Denying Rehearing and Clarifying Order No. 93; Docket No. RM80-33; Order No. 93-A; Issued April 24, 1981, 46 Fed. Reg. 24,537 (May 1, 1981). This discussion is taken from pp. 24,538, 24,540, and 24,543. In an appendix to this order (pp. 24,543 to 24,546) the FERC discussed a variety of issues relating to the pricing question. It noted that gas had a specific water vapor capacity at a set temperature and pressure. When that capacity was reached, the gas was saturated with water vapor. The water vapor capacity would change if either temperature or pressure changes. At the standard measurement condition, the gas would contain approximately 820 pounds of water vapor per million cubic feet. The Commission stated that gas at delivery often contained only about 7 pounds of water vapor per million cubic feet with the amount generally varying between 7 and 70 pounds. At the standard condition (the "wet" rule), water would occupy about 1.74 percent of the total volume while it would occupy about 0.015 percent of the total gas volume under usual delivery conditions. The difference between the standard and actual delivery conditions depended upon temperature and pressure so that no single universal correction factor could be mandated. Thus, the standard would have to be adjusted for the actual delivery conditions for each first sale.} The Commission stated that ceiling prices for first sales of gas from producers to pipelines were determined by multiplying the maximum lawful prices for a particular category of gas, as set by the NGPA, by the number of millions of Btu's (MMBtu) involved. The Commissioners believed that the number of MMBtu's was to be the number actually delivered and not necessarily the number defined by the standard measurement ("wet" rule) condition. Measurement at the standard conditions generally understated the number of Btu's that were actually delivered. The Commission justified its decision further by noting that while the pricing mechanism in the Natural Gas Act of 1938 had been based on volumes of gas (thousands of cubic feet), those prices were on an "as delivered" basis. Continuity between the
NGA and the NGPA thus required the Commission to issue the new rule.39

The Commission stated that Order No. 93 was simply a clarification of the interim rule that it had issued in December 1978. Accordingly, Order No. 93 would apply to all first sales of gas made on or after December 1, 1978, the effective date of the NGPA.

The FERC denied various petitions from parties requesting a stay of the policy, issuing an order on July 30, 1981. However, the Commission reversed itself soon thereafter (on August 20, 1981) by granting a stay of the retroactive application of Order No. 93 for the period from December 1, 1978 (the effective date of the NGPA) to April 24, 1981 (the date of the issuance of Order No. 93-A).

The Commission reversed itself again on December 24, 1981, ruling that the effective date of the "dry" rule should be December 1, 1978. In addition, the Commissioners officially added the "as delivered" language to the FERC regulations, which then stated that "the maximum lawful price prescribed by the NGPA ... for any first sale of natural gas applies to the Btu's actually delivered in that first sale."40

39 The FERC also argued that Congress, in the NGPA, wanted to encourage gas production by pricing the fuel on the basis of its comparable energy value with other fuels. Pricing gas on the basis of its actual heating value, MMBtu's delivered, instead of the understated value from the standard test conditions helped to achieve this congressional objective.

40 See Order Vacating Partial Stay and Amending Regulations; Docket No. RM80-33; Issued December 24, 1981, 47 Fed. Reg. 614 (January 6, 1982) at 615. Whether to soften the blow of the new policy or because it did not feel that the change was major, the Commission stated in this order, "The Commission emphasizes, as it did in Order No. 93-A, that the Btu rule does not require that the industry change its measurement or pricing practices." The rule was merely concerned with determining the first sale price and did not alter methods specified in (continued...)
INGAA v. FERC I

In the December 1981 order, the FERC observed that "numerous" petitions for review of the "dry" rule had been filed with the U.S. Court of Appeals for the District of Columbia Circuit. On August 9, 1983, a three-judge panel handed down its decision in Interstate Natural Gas Association of America v. Federal Energy Regulatory Commission.

In reviewing the history of the regulations, the judges acknowledged that the "wet" rule tended to overstate the water vapor content of gas at delivery. Despite this inaccuracy, however, the rule had been widely accepted by the industry and consistently implemented by the Commission. By 1978, when the NGPA was enacted, the "wet" rule had been in place for over fifteen years (dating from the 1961 policy statement).

The court then reviewed the arguments of the parties. The petitioners, mainly pipelines and distributors, argued that the NGPA did not

(...continued)

contracts between a producer and a pipeline for measuring Btu content. Payment of a price other than that specified in such a contract was also not required by the "dry" rule as long as that contract price was the same as or below the NGPA specified price. See p. 615.

Ibid.

Interstate Natural Gas Association of America v. Federal Energy Regulatory Commission, 716 F.2d 1 (D.C. Cir. 1983). The Interstate Natural Gas Association of America is a major trade group representing the interstate pipelines.

With respect to the "wet" rule, the Commission itself observed in Opinion No. 464 in 1965 that "we note that this standard is accepted by the American Society for Testing Materials and the Natural Gas Industry." See Opinion No. 464, 33 FPC at 1237.
allow the FERC to adopt the "dry" rule. They pointed to indirect congressional endorsement of the "wet" standard and to a lack of congressional criticism of that standard in the legislative history of the NGPA. The Commission responded that the "dry" definition was consistent with the NGPA because Congress, in basing prices on Btu content, intended to measure energy content on the more accurate dry as delivered basis.

The pipelines and distributors also argued that the FERC had violated their constitutional rights to due process by making the rule retroactive to December 1, 1978 and by refusing to guarantee pass through to their customers of any retroactive payments that would have to be made to producers. The Commission argued that it would have been more harmful to deny producers the prices to which they were entitled under the NGPA. Pipelines and distributors could recover these costs from their customers. The Commission would allow pass through on a case by case basis.

The court discussed the various arguments, beginning with the point that the NGPA did not allow the "dry" definition. The judges noted that the NGPA did not mandate either the "wet" or the "dry" definition of Btu content. The Commission’s argument was that the use of Btu based prices in the NGPA meant that there had to be a more accurate measurement of energy content. This was so because Congress had written such a detailed pricing mechanism into the NGPA that the legislators could not have intended to adopt an inaccurate method of price calculations. In addition, inaccurate measurement of Btu content would thwart the objective of setting ceiling prices for gas on the basis of the Btu content of other fuels.

The court stated, however, that the detail of the NGPA actually undermined the Commission’s argument. It was logical to assume that Congress fixed the prices on the basis of the "wet" rule because that was the only method with which Congress would have been familiar at the
time. The panel read the legislative history of the NGPA to find at least indirect incorporation of the "wet" standard into the NGPA, but no indication of any awareness of a "dry" or as delivered method.

The judges rejected the "dry" rule also because they believed that the FERC had overstated the importance of the Btu pricing basis of the NGPA and thus had distorted the ceiling prices that Congress had sought to establish. According to the court, Congress may have assumed that the thousands of cubic feet (Mcf) basis of pricing under the Natural Gas Act was interchangeable with the millions of Btu's (MMBtu) basis incorporated into the NGPA. The shift in the basis of pricing from Mcf to MMBtu may not have been so drastic as to require a rejection of all aspects of Mcf pricing, including the "wet" standard.44

Thus, the judges found the "dry" or as delivered rule to be inconsistent with the NGPA. While it may have appealed to "the Commission's sense of scientific aesthetics and accuracy, it is not for the Commission to 'improve' the statutory design chosen by Congress." The "dry" rule was "fundamentally at odds with the Btu measurement technique implicit in the NGPA," and the court vacated it.45

44 The court also dismissed the Commission's argument on the intent of Congress to compare the Btu content of gas with that of other fuels by noting that the final version of the NGPA had not included the provision adjusting the gas wellhead price on the basis of the current Btu related price of domestic crude oil. In addition, Congress had used standard conversion factors in determining the Btu equivalency of oil and gas in the Energy Tax Act of 1978 (passed at the same time as the NGPA). The court felt that this meant that Congress was not opposed to the standard assumptions underlying the "wet" rule.

45 INGAA v. FERC, 716 F.2d at 15.

176
Commission Response

In responding to the INGAA decision, the FERC first had to change its regulations and then implement a system of refunds to pipelines and distributors of the funds that they had paid to producers under the "dry" rule. As shown below, this latter task proved to be far more controversial and difficult for the Commission to implement than was the former.

The FERC amended its regulations in response to the court decision by issuing Order No. 356 on January 19, 1984. The Commission ordered the standard test conditions, the "wet" rule, to be used to determine the number of Btu's in gas. Thus in determining the maximum lawful payment for gas sold in a first sale, "the standard conditions apply, regardless of the actual delivery pressure and temperature conditions and the actual water vapor content of gas delivered by a first seller." The amended regulation was made effective retroactive to December 1, 1978 and was to be complied with in all subsequent transactions.

For sales that had occurred prior to the issuance of Order No. 356 back through December 1, 1978, the Commission commenced a rulemaking proceeding on how to handle the refunds. The Notice of Inquiry

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47 Ibid., p. 3,073. The Commission stated that the case had been appealed to the Supreme Court and that its order might be subject to any further orders from that court. However, the Supreme Court denied certiorari on March 19, 1984 (reported as Exxon Corp. et al. v. Interstate Natural Gas Association of America et al. and Federal Energy Regulatory Commission v. Interstate Natural Gas Association of America et al. at 465 U.S. 1108. Justice White would have granted certiorari.)
(NOI) was issued at the same time as Order No. 356. In the NOI the FERC stated that "as a result of the court's opinion lower payments should have been made for gas sold under the NGPA since December 1, 1978." Sellers of gas who priced their fuel on the basis of the "dry" rule, the Btu content when delivered, were thus overpaid and would have to refund those amounts. The Commission was "required to adhere to" and "develop procedures to implement the court's decision." The FERC sought comments on what procedures it could use to monitor refund payments and insure that the refunds were passed through to the pipelines' customers. The Commission believed that monitoring would be necessary because large amounts of revenues were involved.

The FERC issued an interim rule on May 3, 1984. In this rule, the Commissioners stated that any first seller of gas who collected revenues in excess of the product of the applicable NGPA maximum lawful price and the quantities of millions of Btu's determined by the standard test conditions (the "wet" rule) had to refund the excess. If revenues received were less than or equal to this product and were authorized by contract, then no excess had been collected and no refund was required.

The Commission also encouraged the pipelines to pursue actively the refunds that were owed to them. The Commissioners stated their belief that the pipelines "have an obligation under the Natural Gas Act as

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49 Ibid., p. 3,199.

part of prudent management to ensure that producers pay these re-
funds.\textsuperscript{51}

The FERC issued a final rule, Order No. 399, in September 1984
implementing the interim order with some modifications.\textsuperscript{52} This order is
especially notable for some other points that the Commission made. The
first is the tone of resignation in the Commissioners' statement on why
they were issuing the order.

When the Commission promulgated the dry rule, it
believed that the dry rule [w] as an appropriate method per-
mitted by Congress for measuring the Btu content of natural
gas under the NGPA. The court in \textit{INGAA} disagreed. We
are now left with the task of implementing the court's deci-
sion.\textsuperscript{53}

The Commission felt that Order No. 399 was a good balance of the
interests of sellers, purchasers, and consumers.

The second notable point is the Commission's explanation of why it
was undertaking the refunds. Some commenters on the interim rule had
argued that the FERC could have decided not to order the refunds
because neither the NGPA nor the court's decision in \textit{INGAA} had
explicitly required them.\textsuperscript{54}

\footnote{51}{Ibid., p. 19,297.}

\footnote{52}{See Refunds Resulting from Btu Measurement Adjustments; Final
Rule; Docket Nos. RM84-6-000, RM84-6-001, and RM84-6-002; Order
No. 399; Issued September 20, 1984, 49 \textit{Fed. Reg.} 37,735 (September 26,
1984).}

\footnote{53}{Ibid., p. 37,737.}

\footnote{54}{Those parties made several other arguments. They were first that
producers had relied on the "dry" rule in making investment decisions;
second, that the status quo could not be restored as there were
(continued...)}
The Commissioners disagreed, stating that

Under the *In re GAA* decision, the NGPA, and the Commission's implementing NGPA regulations, the Commission believes that it is legally required to order refunds in this situation. Specifically, the NGPA establishes ceiling prices and makes it unlawful for a first seller to receive a price in excess of the maximum lawful price. If the Commission did not make the measurement rule retroactive and did not require refunds, it would effectively be establishing a ceiling price higher than the maximum lawful prices prescribed in the NGPA. Since the NGPA does not contain any provision allowing the Commission to change the maximum lawful prices except in very limited circumstances, it cannot waive the refund obligation.\(^5\)

The Commissioners recognized the administrative burdens involved and also the possibility that refunds to some overcharged customers would be impossible. However, they believed that overriding legal considerations required that refunds be made.\(^6\)

The third point to note about this order, especially in light of subsequent events, is that the FERC refused to allow producers to offset their Btu refund debts to pipelines with funds owed to them by the pipelines under section 110 of the NGPA (in effect, to allow the debts to cancel out each other). Section 110 allowed the first sale prices charged by producers to exceed maximum lawful prices if necessary to collect

\(^{5}\)\(...continued) insufficient records; third, that individual consumers would not receive the benefits of the refunds; fourth, that the administrative burden of refunds would be great; and fifth, that the refunds would discourage producers from undertaking new drilling and exploration.

\(^{5}\) Ibid. Citation omitted.

\(^{6}\) Ibid.
various production related costs from pipelines (or other customers in a first sale).

In its decision not to allow offsets, the Commissioners reasoned that the section 110 policies were to be self-implementing while the Btu refunds were to be closely monitored and conducted through specific procedures. Offsetting the two types of costs would also complicate the process of the Btu refunds and make it more difficult for the FERC to monitor them. In addition, the Btu refunds might not reach as many of the customers actually overcharged if balanced against the section 110 costs.\(^{57}\)

Soon thereafter, in October 1984, the Commission granted rehearing of Order No. 399.\(^{58}\) In November of that year, the FERC issued Order No. 399-A.\(^{59}\)

Over the dissent of two of its five members, the FERC in Order No. 399-A reversed itself and decided to allow the offset of the section 110 costs with the Btu refunds, citing support from both producers and pipelines for the offsets. The majority believed that the offset would match better the customers entitled to the Btu refunds with the customers who caused the section 110 production costs to be incurred. 

\(^{57}\) Ibid., pp. 37,738-37,739.

\(^{58}\) The Commission stated, "with respect to the petitions for rehearing, we are concerned that all parties to this proceeding who may desire judicial review of Order No. 399 have an opportunity to seek such review of our final disposition of the petitions for rehearing on the merits." See Refunds Resulting from Btu Measurement Adjustments; Order Granting Stay and Rehearing for Purpose of Further Consideration; Docket Nos. RM84-6-003 through RM84-6-014; Issued October 24, 1984, 49 Fed. Reg. 43,543 (October 30, 1984) at 43,544.

\(^{59}\) See Refunds Resulting from Btu Measurement Adjustments; Order Granting in Part and Denying in Part Rehearing; Docket Nos. RM84-6-003 through 014; Order No. 399-A; Issued November 20, 1984, 49 Fed. Reg. 46,353 (November 26, 1984).
made payments for gas under the "dry" rule mainly in 1982 and 1983 while section 110 costs were incurred by producers for services rendered from 1980 through early 1983. Thus, there was a large degree of overlap between the two groups of customers: those entitled to the Btu refunds and those responsible for the section 110 production costs.\(^6\)

\(\text{\textsuperscript{6}}\) Ibid., pp. 46,356-46,358. The Commission also wanted to avoid any disruption of the gas market that might have resulted from the Btu refunds and section 110 payments as decontrol approached. The NGPA had mandated the price deregulation of a large portion of natural gas on January 1, 1985. The Commissioners feared that prices may have been disrupted and consumers faced with large rate increases as pipelines and producers tried to obtain the revenues needed to pay off their debts to each other.

It is also interesting to note some of the language used by the Commission in this opinion, perhaps indicating an increasing distance from the original "dry" rule policy. In response to some comments that refunds were not required, the Commissioners stated:

Many first sellers participated extensively in the litigation that ultimately resulted in the dry rule being struck down. The Commission defended its adoption of the dry rule vigorously. The Commission's position, as well as that of first sellers, was decisively rejected by the United States Court of Appeals, and the Commission's petition for certiorari was denied by the Supreme Court. Having lost that dispute, the first sellers cannot reasonably conclude that they are nevertheless entitled to retain the economic benefits they would have enjoyed had they prevailed.

Ibid., p. 46,354. A comment by Commissioner Oliver G. Richard III, who agreed with the offset procedure but dissented from another part of the order, is in a similar vein. Richard stated that "the Commission should recognize that difficulties associated with the refund process are due, in part, to our erroneous interpretation of the NGPA that the Court corrected." Ibid., p. 46,363. Richard was not on the Commission when the "dry" rule was promulgated. His role in promoting the offset procedure is discussed in Chapter 4.
After the issuance of Order No. 399-A, the Associated Gas Distributors, a trade association representing local gas distribution utilities, filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit. Local distributors are major customers of the pipelines and thus recipients of the Btu refunds. They are the third major party touched by this case. The group requested the court to enforce its mandate in INGAA v. FERC I and order the FERC to direct gas producers to pay the refunds required by the change in Btu measurement from the "dry" to the "wet" rule.

The court issued its decision in March 1985. The judges stated that there had been two consequences of the first INGAA decision. The FERC was to "implement the proper pricing method for future pricing decisions, and remedy the effects of past use of the improper pricing method at the earliest possible moment." The panel recognized that the FERC had complied with its order by reinstituting the "wet" standard and by issuing Order No. 399 requiring refunds and prohibiting offsets.

The court decided to use the motion filed by the Associated Gas Distributors to compel FERC compliance with the first INGAA decision as a petition to review Order No. 399-A. The Commission argued that the INGAA I ruling had not prohibited the offset procedure allowed by Order No. 399-A. The judges, however, disagreed.

Turning then to the substance of the dispute before us, we conclude that the offset provision contained in Order No.

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62 Ibid., p. 168.
399-A must be set aside. As stated above, FERC issued Order No. 399, in which offsets were explicitly prohibited. Shortly thereafter, FERC issued Order No. 399-A, in which offsets were permitted. While an agency may change its course, it can do so only with a full and complete explanation that would withstand judicial review. FERC's Order 399-A does not meet that requirement. Without such an explanation, the agency's decision may be arbitrary and capricious.63

The judges stated that Order No. 399-A also defied a 1962 Supreme Court decision that the Commission must, whenever any refunds were due, direct their payment as soon as possible. Using the offset procedure would only result in further delay of the refunds due customers who were overcharged.

The prohibition of offsets in Order No. 399 had been reasonable. Offsets would frustrate the court's intentions expressed in the mandate of INGAA I as well as the Supreme Court's 1962 decision on refunds. The court directed the FERC to vacate the offset portions of Order No. 399-A "for the reasons set forth in its own Order No. 399."64

Commission Response to INGAA II

The Commission issued Order No. 399-B in July 1985, vacating the offset mechanism of Order No. 399-A.65 The Commissioners noted that

\footnote{Ibid., p. 170.}

\footnote{Ibid., p. 171.}

\footnote{See Refunds Resulting from Btu Measurement Adjustments; Order on Remand and on Petitions for Rehearing and Reconsideration; Final Rule; Docket Nos. RM84-6-015 through 028; Order No. 399-B; Issued July 18, 1985, 50 Fed. Reg. 30,141 (July 24, 1985). In this order, the Commission considered the issue of whether or not refunds were required to implement the INGAA I decision. In responding briefly to one (continued...)}
many first sellers had offset hundreds of millions of dollars of Btu refunds that they owed against uncontested section 110 charges that were owed to them. The Commission in vacating the offset ordered the producers to pay the Btu refunds in full. The FERC subsequently denied a request for a stay of this order.\(^{66}\)

\(^{65}\)...continued\)

petition for rehearing, the Commissioners stated that equitable considerations required the refunds. The consumers who were overcharged should benefit from the refunds. In addition, the Commissioners stated that "in any event, the opinion of the Court of Appeals in \textit{INGAA-II} leaves no doubt that refunds were required to implement that Court's earlier decision in \textit{INGAA-I}." (Citation omitted, see ibid., p. 30,143.)

The Commission also noted in Order No. 399-B that the D.C. Court had denied a motion for a stay of its order on May 20, 1985. That motion had been filed by the Indicated Producers. The mandate of the court was then issued. Chief Justice Burger denied a petition for a stay of the mandate on June 3, 1985. See ibid., p. 30,142, n. 8. The Supreme Court denied \textit{certiorari} in October 1985. See Pennzoil Company et al. v. Associated Gas Distributors et al., 474 U.S. 847 (1985).

The FERC also issued Order No. 94-F in response to the \textit{INGAA-II} decision. This order was concerned with the undisputed section 110 costs and set a new deadline for actual payment (instead of the use of the vacated offset procedure) of these costs by pipelines to producers. See Regulations Implementing Section 110 of the Natural Gas Policy Act and Establishing Policy; Order Scheduling Payment of Undisputed Section 110 Charges Offset against Btu Refunds; Docket No. RM80-47-000; Order No. 94-F; Issued July 29, 1985, 50 \textit{Fed. Reg.} 31,347 (August 2, 1985).

\(^{66}\) See Refunds Resulting from Btu Measurement Adjustments; Notice [Denying Stay]; Docket Nos. RM84-6-015 through 032, 32 FERC para. 61,336 (Issued August 26, 1985). As an indication of how this controversy continued and the Commission's diligence in implementing the court's decision, it is interesting to note that the FERC issued a notice in June 1992 stating that efforts to collect refunds in 124 cases were being discontinued. The first seller could not be located in 111 of the cases and bankruptcy proceedings had liquidated the assets of the first sellers in the other 13. The Commission stated that as a result of the Order No. 399 series over $1 billion had been refunded by first sellers. Pipelines had...
The Commission's response to the court orders in INGAA contains some important similarities to its actions in the Mid-Louisiana case. In both cases, both implementation and evasion are seen at the same time. As with Mid-La, the FERC sought to evade the adverse court order in INGAA by an appeal to the Supreme Court while at the same time proceeding with implementation (by reinstating the wet rule and beginning the rulemaking on refunds). Implementation continued with the issuance of a rule on refunds although the use of the offset procedure might be interpreted as an attempt to avoid or evade the full impact of the first INGAA ruling. However, and again similarly to Mid-La, implementation proceeded after a subsequent judicial ruling.

The Maryland People's Counsel Cases

The Maryland People's Counsel cases involved special marketing and transportation programs that the Commission had approved for use by interstate pipelines. They were criticized as being discriminatory

\[\ldots\text{continued}\]

then reported that over $140,000,000 had not been collected in 5,610 cases. Commission staff "actively pursued payment" of the outstanding refunds and as of May 1, 1992 only 692 cases involving $28.7 million of outstanding refunds remained. In 1990 and 1991 the Commission had ceased efforts to collect refunds in approximately 400 cases (356 where the seller could not be located and 45 in which the seller's assets had been liquidated in bankruptcy). In the June 1992 cessation, the 111 first sellers that could not be located owed $1,061,966 while the 13 that had been liquidated in bankruptcy owed $154,700. The Commission noted, however, that staff would maintain a database and cases would be reactivated if warranted. See Refunds Resulting from Btu Measurement Adjustments, Docket No. RM84-6-037; Notice of Decision to Cease Efforts to Collect Certain Btu Refunds, 59 FERC para. 61,299 (Issued June 10, 1992).
against those classes of customers (mainly residential) that were excluded from their provisions.

In the early 1980s, decreasing demand for natural gas resulting from increased energy conservation (due at least partly to higher energy prices), and economic downturn along with a constant nondeclining supply of gas resulted in a surplus of the fuel, a so-called gas bubble. In addition, a drop in the price of oil made that fuel more attractive to those customers, mainly large industrial (noncaptive) customers, who were able to switch the fuels they used, depending on which fuel was cheaper.67

One response of the industry and the FERC to this situation of surplus supply and the potential loss of customers to cheaper alternative fuels was to initiate special marketing programs (SMP). Another was to employ blanket transportation certificates to move gas more expeditiously. Blanket certificates are considered first.68


68 For a more extended discussion of blanket certificates, special marketing programs, and the resulting litigation and FERC orders, the reader is referred to Robert E. Burns, Daniel J. Duann, and Peter A. Nagler, *State Gas Transportation Policies: An Evaluation of Approaches*, NRRI 88-21 (Columbus, OH: The National Regulatory Research Institute, 1989), pp. 87-155.
Blanket Certificates

Blanket certificates were issued by the FERC under its NGA section 7 authority to issue certificates of public convenience and necessity. The intent of the program was to simplify procedures by allowing automatic authorization for certain pipeline activities instead of individual case-by-case authorizations. Case-by-case authorization would still be required for some pipeline activities or projects, but not for more routine types of activities.

As the following chronology shows, the Commission continually expanded the numbers of activities and participants that could be part of the blanket certificate program. One group that was consistently excluded, however, was residential consumers. This exclusion eventually left the program open to a court challenge from the Maryland People's Counsel.

The Commission issued two Notices of Proposed Rulemaking (NOPR) on blanket certificates in 1981. In the first, in March of that year, the FERC proposed to modify its then current blanket certificate transportation program. The Commission was allowing an interstate pipeline to transport gas on behalf of any other interstate pipeline. Under authority granted to it by section 311 of the NGPA, the Commission was also allowing an interstate pipeline to transport gas for an intrastate pipeline or local distribution company. Transactions were limited to two years or less duration.\(^69\)

In the NOPR, the Commissioners proposed permitting transactions to last longer than two years after first publishing a notice of an intended

business deal and then allowing parties the opportunity to intervene and perhaps protest that arrangement. A pipeline’s current capacity would have to be sufficient to carry out the transaction and the gas would ultimately have to become part of a pipeline’s or local distributor’s system supply for later sale to customers.™

Automatic authorization of gas transportation for certain customers (also known as end-users) was also available under the blanket certificate. At the time of the NOPR, the FERC had transportation programs in place under various orders. Transportation service was provided under the orders for such customers as schools, hospitals, or commercial or agricultural customers. One program provided for transportation to further the goal of using gas instead of fuel oil.

These programs generally required separate certification for each transaction. The Commission proposed automatic authorization for transactions of up to five years’ duration. Arrangements lasting longer than five years would be approved after allowing interested parties the opportunity to intervene, comment and possibly contest the proposal through the notice and protest procedure.™

In June 1982, FERC Order No. 234, which resulted from the NOPR just described, was published in the Federal Register.™ The transportation proposal from the NOPR, however, was reserved for consideration in the other ongoing rulemaking mentioned above.™

™  Ibid., p. 16,906.

™  Ibid., pp. 16,905-16,906, 16,911.


™  Ibid., p. 24,265. In August 1982, the FERC issued Order No.

(continued...)
In the second Notice of Proposed Rulemaking, which the FERC issued in 1981, the Commission made a variety of suggestions to expand the scope of the blanket certificate program beyond the framework of the first rulemaking just described. For example, it was proposed to eliminate or modify existing restrictions on the amount and uses of gas bought directly by end-users from producers and transported with a blanket certificate. These end-users included various commercial, industrial, and agricultural customers, and schools, and hospitals. Transportation could be provided for up to five years without requiring FERC approval. This NOPR also included proposals to make it easier for interstate pipelines to transport gas for intrastate pipelines or vice versa under NGPA section 311.

In July 1983 the FERC issued orders in the two blanket certificate dockets discussed above. In Order No. 319, derived from the second NOPR just discussed, the Commission officially added the new transportation rule to its regulations. As proposed, the Commission eliminated

\( \ldots \text{(continued)} \)

234-A. Among its provisions was a requirement for certificate holders seeking to undertake projects subject to the notice and comment procedures to submit additional data on the impact of a proposed project or service on the certificate holder's current service. See Interstate Pipeline Certificates for Routine Transactions; Order Granting in Part and Denying in Part Applications for Rehearing; Docket Nos. RM81-19-000 through RM81-19-009; Order No. 234-A; Issued August 31, 1982, 47 Fed. Reg. 38,871 (September 3, 1982).


\( ^75 \) Ibid., pp. 24,587-24,589.

\( ^76 \) Sales and Transportation by Interstate Pipelines and Distributors; Expansion of Categories of Activities Authorized under Blanket (continued...)
limitations on the amount of gas that could be transported for high priority customers (schools, hospitals, and certain agricultural and industrial users). The FERC also retained the authority to designate other end-uses as eligible for transportation under the blanket certificate.

76 (...)continued

77 Ibid., p. 34,877. Section 401(f)(2) of the Natural Gas Policy Act defined "high-priority user" for purposes of the curtailment, when necessary, of gas service by an interstate pipeline. The definition of "high-priority user" was:

(2) HIGH-PRIORITY USER.--The term "high-priority user" means any person who--

(A) uses natural gas in a residence;

(B) uses natural gas in a commercial establishment in amounts of less than 50 Mcf [50 thousand cubic feet] on a peak day;

(C) uses natural gas in any school, hospital, or similar institution; or

(D) uses natural gas in any other use the curtailment of which the Secretary of Energy determines would endanger life, health, or maintenance of physical property.

See 15 U.S.C. sec. 3391(f)(2)(1988). In Order No. 319, however, the Commission's definition of high-priority use did not include residential use. See Order No. 319, p. 34,888.

78 Two other points, important for considering the later court challenges, ought to be mentioned about this order. First, the FERC agreed to a suggestion allowing for automatic authorization of transportation to last up to ten years (or the life of the gas reserves whichever was less) when the high-priority end-user had developed its own gas reserves. In the rulemaking that the Commission commenced at the end of 1984 and which responded at least partly to the Maryland People's Counsel decisions (Order No. 436), the FERC decided to grandfather into the new rule some of the old blanket certificate authorizations. The court subsequently reviewing Order No. 436 expressed concern about the length of such transactions, observing that some would last up to ten years and

(continued...)
The second order issued by the FERC in July 1983 pertained to both of the blanket certificate rulemakings. In Order No. 234-B, the FERC expanded the blanket certificate program to authorize transportation for more types of customers. While Order No. 319 had authorized transportation for high-priority users, Order No. 234-B allowed transportation of direct sale gas (generally gas purchased by the customer directly from the producer instead of by the customer from the pipeline which had purchased from the producer) under blanket certificates for lower priority industrial and boiler fuel users. This was to be a two-year experiment, until June 30, 1985.

A few months later, in November 1983, the FERC issued Order No. 319-A, granting in part and denying in part rehearing of Order Nos. 234-B

78 (...continued)
asked the Commission to justify this decision.

Another point about Order No. 319 is that the FERC decided to allow pipelines to charge an end-user up to five cents per million Btu of transported gas. The Commissioners approved this Additional Incentive Charge as an experiment to last eighteen months after observing that their attempts to encourage transportation by pipelines for end-users had "met with only limited participation" up to that point. They noted that the courts had approved such experiments when the FERC was searching for solutions to major problems facing the gas industry. However, the experiments had to be for a limited time and the results carefully analyzed. See Order No. 319, 48 Fed. Reg. at p. 34,881. This experiment logic was used on more than one occasion by the FERC to justify to such intervenors as the Maryland People's Counsel and to the court its exclusion of core residential customers from its transportation programs.


80 Ibid., p. 34,873.
and 319. Of particular relevance for this study in light of the arguments made against blanket certificates by the Maryland People’s Counsel, the FERC was not convinced by arguments that the program would harm residential and commercial customers because only industrial end-users would be able to take advantage of its benefits. In response, the Commission stated that if the program resulted in direct sales from producers to customers (instead of the usual producer to pipeline to customer route) who would have otherwise changed to alternative fuels, those direct sale customers would continue to shoulder some of the transporting pipeline’s costs. This result would be beneficial to the pipeline’s other customers such as local distributors. Blanket certificates would also create incentives for pipelines to keep their prices for delivered gas competitive because customers would be able to shop around for alternative supplies. In the view of the Commission, these developments would benefit all customers, including residential and commercial.\(^\text{82}\)

\(\text{81}\) Interstate Pipeline Blanket Certificates for Routine Transactions and Sales and Transportation by Interstate Pipelines and Distributors; Order Granting in Part and Denying in Part Applications for Rehearing of Order Nos. 319 and 234-B; Docket Nos. RM81-19-000 and RM81-29-000; Order No. 319-A; Issued November 3, 1983, 48 Fed. Reg. 51,436 (November 9, 1983). The Commissioners decided to expand the number of first sellers eligible to have gas transported to include any first seller except pipelines selling their own production. The Commissioners made this exclusion because they had not yet implemented the \textit{Mid-Louisiana} decision. See Order No. 319-A, p. 51,440.

\(\text{82}\) Ibid., p. 51,438. The Commission did not name the parties claiming that residential and commercial consumers would be harmed although the People’s Counsel was listed as having submitted an application for rehearing. MPC was a late participant in the blanket certificate rulemaking process. The People’s Counsel told the court in the second \textit{MPC} decision that it had not intervened earlier because the NOPRs for Order Nos. 319 and 234-B had not suggested the possibility that fuel-switchable end-users would be included in the blanket certificate program. (See 761 F.2d 780 at 784, n. 10).
On March 22, 1985, the FERC issued a Notice of Proposed Rule-making on blanket certificates. In this Notice, the Commission proposed a six-month extension (to December 31, 1985) of the Order No. 234-B direct sale transportation program for low-priority customers, such as industrial and boiler-fuel users. Although they claimed that the Order No. 234-B program had met their expectations in terms of moving fuel "expeditiously" to end-users, the Commissioners stated that they wanted "the benefit of further study...."

In the rule that the FERC fashioned from the above mentioned NOPR, issued on June 17, 1985 (after the *Maryland People's Counsel* decisions), the Commission decided on an extension of the blanket certificate Order No. 234-B program until October 31, 1985 or the effective date of a final rule in the Order No. 436 docket. This new deadline replaced the originally proposed December 31, 1985 date.

The Maryland People's Counsel opposed the extension, arguing that the FERC should issue a rule that required nondiscriminatory access to blanket certificate transportation. The Commission, however, sought to avoid any disruption in current transportation arrangements. The proposed rule that would become Order No. 436 (mandating nondiscriminatory access) had been issued and the Commissioners wanted to analyze

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84 Ibid., p. 12,327 (reference omitted in quotation).

85 Interstate Pipeline Blanket Certificates for Routine Transactions and Sales and Transportation by Interstate Pipelines and Distributors; Final Rule; Docket Nos. RM81-19-000 and RM81-29-000; Issued June 17, 1985, 50 Fed. Reg. 25,701 (June 21, 1985). The FERC applied for a stay of the Court's order in the *Maryland People's Counsel II* case to allow for this extension. As discussed below, the stay was granted.
the industry's comments on it. At the same time, the FERC did not want the Order No. 234-B program to lapse in the interim. Thus, the Commissioners denied the People's Counsel's request but decided on the earlier deadline.86

Special Marketing Programs

Special Marketing Programs (SMP) were another type of transportation policy pursued by the FERC in the early and middle 1980s in response to the gas market conditions at that time. In a special marketing program, gas committed by a producer to a pipeline would be released from that contract by the pipeline and made available to other customers, such as industrial end-users or other pipelines. The price would be negotiated by the producer and the new buyer and it could not exceed NGPA ceiling prices. The customers of the pipeline involved in the original contract with the producer could also purchase the gas as part of their entitlement to a firm (i.e. uninterruptible) gas supply. The pipeline releasing the gas would transport the fuel to the new buyer, although transportation service under SMPs was to be secondary to the pipeline's regular commitments.87

The aims of special marketing programs, according to the Commission, were "to recapture lost markets, retain existing markets, and acquire new markets."88 The advantages of the SMPs, again quoting the FERC, were "that the seller generates revenues, the pipeline is relieved of

86 Ibid., pp. 25,702-25,703.
88 Ibid., p. 7.
take-or-pay liability, and the new buyer acquires cheaper gas." The Commission also stated that SMP gas had frequently replaced alternative fuels and thus increased gas consumption.

An important characteristic of the special marketing programs was that like the blanket certificate program not all customers were allowed to participate. The programs were aimed mainly at noncaptive customers, those customers such as large industrial facilities that had the ability to switch fuels. Captive customers, such as residential consumers, were not included and just as with the blanket certificates this exclusion was the basis for the court challenge brought by the Maryland People's Counsel.

The Commission and the industry moved fairly rapidly in developing and implementing the special marketing programs. By the end of fiscal year 1984 (September 30, 1984), ten programs involving six pipelines and four producers had been authorized by the FERC. During fiscal

89 Ibid. The take-or-pay issue is very important in the rest of this discussion of the Maryland People's Counsel cases and the ensuing developments and should be briefly discussed at this point. Take-or-pay clauses were important and controversial provisions of contracts between pipelines and producers. In a take-or-pay provision, the pipeline agreed to pay the producer for a specified percentage of the gas under contract regardless of whether the gas was actually taken by the pipeline. Thus, a pipeline could not "simply turn to less expensive sources of supply if the wellhead price of gas falls, since it has contractual obligations to purchase a fixed amount from its current suppliers." See Kevin A. Kelly et al., State Regulatory Options for Dealing with Natural Gas Wellhead Price Deregulation, NRRI 83-7 (Columbus, OH: The National Regulatory Research Institute, 1983), pp. 28-29, 290. Because of their take-or-pay obligations, pipelines were at times forced to continue to take and try to sell expensive gas (covered by these contract provisions) instead of taking cheaper gas. As shown below, the FERC incorporated take-or-pay relief into the special marketing programs.
year 1985, the Commission approved forty-three SMPs involving producers or gas brokers.\textsuperscript{90}

The special marketing program of Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company was approved by the FERC in November 1983.\textsuperscript{91} Because that program was the target of the Maryland People's Counsel litigation, it serves as the focus of the following discussion.

Earlier in 1983, because of an oversupply of fuel and declining markets, Columbia had sought to reduce its required purchases below the levels mandated by the take-or-pay and minimum daily purchase provisions in its contracts with its gas suppliers. Columbia reached an agreement with Exxon, its largest supplier, providing that Exxon could sell gas released from its contract with Columbia directly to industrial customers on Columbia's system to prevent those customers from switching to fuel oil. The released gas could also be sold to industry for the purposes of reopening a closed plant or preventing an imminent plant closing. Other customers would be eligible to purchase the released gas after Columbia's industrial customers had had the opportunity to do so. Columbia was to


be credited against its take-or-pay obligation to Exxon for gas sold by that producer under the agreement.

The FERC approved the SMP with some modifications. One such change dealt with eligible purchasers of gas under the SMP. The Commission decided that local distribution companies should be allowed to participate in addition to end-users. The Commission ordered that sales would be restricted to end-uses not served up to that point by gas or to requirements which were being or would otherwise have been served by alternative fuels. Captive (or core) customers, those who could not easily switch to other fuels or to other suppliers of gas, were not eligible to participate in the program.\textsuperscript{92}

The order included a discussion of the objections to the program by some intervenors, including the Maryland People's Counsel (MPC) which requested that the FERC dismiss Columbia's application for several reasons. It stated that the SMP amounted to the sale of general system supply gas at a price below the system's weighted average cost of gas, resulting in increased average purchased gas costs. The MPC also stated that the program discriminated against the noneligible customers who would be forced to pay the increased purchased gas costs. The SMP would also fail to place any downward pressure on wellhead prices, but instead would maintain prices at higher levels.\textsuperscript{93}

The Commission reacted to some of these objections in the November order. For example, its response to the claim that the SMP would increase the charges to the pipeline's customers was to require that the price of gas released from contractual obligations and made part of the

\textsuperscript{92} Ibid., p. 61,565.

\textsuperscript{93} Ibid., p. 61,562. Note that unlike blanket certificates, the MPC was an early intervenor in the SMP process. This was probably because of the local interest in that Columbia is a major supplier of fuel to Maryland.
SMP must be equal to or greater than the Columbia system weighted average cost of gas. The Commission also stated that it wanted to protect pipelines from the potential loss of their core markets under the program and that was the reason why such customers would not be allowed to participate.94

The Commission noted that it was engaging in testing and experimenting with potential solutions for the problems of the gas industry. The order included this assertion: "this Commission believes that the approach to the existing problem contemplated herein is totally consistent with the mandate given to other independent Federal regulatory agencies to test remedies of an experimental, limited-term nature to protect the public interest."95 The order also included a quote from a District of Columbia Court of Appeals order that "a month of experience will be worth a year of hearings."96

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94 Ibid. The weighted average cost of gas (WACOG) was the "cumulative addition of a pipeline's gas supplies divided by the dollars spent for those volumes." If a pipeline bought 100 Mcf of gas for $110 the WACOG would be 91 cents. If the pipeline paid $90 for that same amount, the WACOG would be $1.10. The Commission had required that gas released into a special marketing program be priced at or above the pipeline's WACOG. Releasing such higher cost gas would lower the WACOG of the remaining fuel and thus lower the price charged to the pipeline's customers. See "WACOG: Old Accounting Concept Figures in Gas Industry's Special Marketing Programs," FERC Monitor, January 26, 1984, p. 1.

95 Ibid., p. 61,563.

96 Ibid., p. 61,564. On December 20, 1983, the FERC issued an order clarifying the November order and granting rehearing and denying the request of the Maryland People's Counsel that it vacate or stay the November order. See Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company, Docket No. CP83-452-001; Order Clarifying Prior Order and Granting Rehearing for the Purpose of Further Consideration, 25 FERC para. 61,401 (Issued December 20, 1983).
In January 1984, the FERC issued an order clarifying the prior special marketing program orders.\textsuperscript{97} The Commission reaffirmed its November 1983 order and also discussed at some length the objections to the SMP policy. Customers not eligible to participate "will benefit from the fixed-cost [the costs of operating and maintaining the pipeline] recovery that might not otherwise occur as well as the avoidance of costs associated with take-or-pay obligations that might otherwise occur."\textsuperscript{98} The Commission stated its satisfaction that all customer classes and the industry as a whole could benefit from the program. At least, "no class of customer will be any worse off as a result of the program."\textsuperscript{99}

The Commission proceeded to discuss in more detail the objections raised by various intervenors, including the Maryland People's Counsel (MPC) and the Process Gas Consumers Group (PGC) which represented some industrial consumers. One objection was that the exclusion of the core markets (captive customers) was discriminatory against those customers and anticompetitive. The Commission, in answering, noted its concern at the prospect that any core customers leaving a pipeline's system would increase the costs of those core customers unable to shift.

The MPC and the PGC also claimed that the special marketing program reinforced the anticompetitive behavior of interstate pipelines. The pipelines possessed monopoly power and were unwilling to provide gas transportation on a nondiscriminatory basis. The program would

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\item \textsuperscript{97} Columbia Gas Transmission Corporation and Columbia Gulf Transmission Company, Docket No. CP83-452-001, et al.; Order Clarifying Prior Orders and Denying Rehearing, 26 FERC para. 61,031 (Issued January 16, 1984).
\item \textsuperscript{98} Ibid.
\item \textsuperscript{99} Ibid.
\end{itemize}
shield Columbia from market competition and keep its prices to high priority users at a high level.\textsuperscript{100}

The Commissioners acknowledged the gravity of the anticompetitive arguments, stating that the concerns "gave us pause" even before the MPC and the PGC had raised them. Nevertheless, they concluded that the intervenors had misunderstood the scope and impact of the November 1983 order. The order was not intended to limit competition, which played a useful role in the gas industry. The anticompetitive concerns could not be dismissed but it was "neither appropriate nor possible" to assess the impact of the SMP policy at that time. The SMP experiment was unpredictable. It did introduce new competition for some loads, although not for the core markets. The Commission stated that "whether we take additional steps, \textit{e.g.}, to embrace core markets in our experiment, is a matter left for future determination. For now, our experiment must be carefully circumscribed so as not to offend seriously the underlying regulatory strictures."\textsuperscript{101}

The Commission also noted that concern for the financial health of the pipelines with its effect on service reliability was a reason for not including firm, core markets in the program.

The pipelines have made long-term supply commitments, have designed their operations, and have major investments in pipeline capacity and other facilities, \textit{e.g.}, above ground and underground storage and synthetic gas, in order to serve these markets. Under competition, there would be winners and losers and the pipelines that lost firm markets would be forced to attempt to recover their costs from other captive markets that were unable to take advantage of competition. The shifting of these costs could constitute undue

\textsuperscript{100} Ibid., p. 61,085.

\textsuperscript{101} Ibid., pp. 61,085-61,086.
discrimination. On the other hand, failure to recover these costs could place the pipeline in financial jeopardy which could affect the reliability of service to those customers and consumers dependent upon the pipeline.\(^{102}\)

The Commission was "not yet prepared to say that competition for the firm markets would achieve a net benefit." However, the Commissioners stated that "we have not spoken our last word on this subject." They noted that they were issuing a Notice of Inquiry on the special marketing programs.\(^{103}\)

After reviewing the comments received in response to the Notice of Inquiry and from a public conference, the FERC, in September 1984, issued an omnibus order extending and modifying the special marketing programs in effect at that time.\(^{104}\) The Commission stated that

\(^{102}\) Ibid., p. 61,087.

\(^{103}\) Ibid. In the Notice of Inquiry just mentioned, the Commission stated that it was concerned about the "inherent economic discrimination" of the SMPs against pipeline customers who were not eligible to receive gas under the programs. It would approve only those SMPs with a net benefit to the direct and indirect pipeline customers who were not eligible to receive gas even though some discrimination may have resulted.

The Commission requested comments on a variety of questions and issues, including whether pipelines with special marketing programs should be allowed to compete for the core markets of other pipelines or local distributors. The FERC also asked whether residential, commercial, agricultural, and other firm customers should be able to participate in the programs. See Inquiry on Impact of Special Marketing Programs on Natural Gas Companies and Consumers; Notice of Inquiry; Docket No. RM84-7-000; Issued January 16, 1984, 49 Fed. Reg. 3,193 (January 26, 1984) at pp. 3,194-3,195, and 3,196.

\(^{104}\) Tenneco Oil Company, Houston Oil & Minerals Corporation, Tenneco Exploration, Ltd., Tenneco Exploration II, Ltd., Tinco, Ltd., and Tenneco West, Inc., Docket Nos. CI83-269-000 through CI83-269-023, et al.; Order Amending Certificates of Public Convenience and Necessity, (continued...)
experience with the programs up to that point showed that customers, pipelines, and producers were benefiting. The Commissioners did not want the experiment to end as the industry and its customers still were facing the problems that brought about the SMPs and so they extended the programs for one year until October 31, 1985.\textsuperscript{105}

In response to the arguments that the programs were discriminatory, the FERC decided to expand them in a limited fashion to include firm service customers. Firm customers, such as local distributors, of a pipeline releasing gas in a special marketing program could request that up to ten percent of their firm supply entitlement be purchased under the SMP. These firm customers could purchase gas either for their own systems (to be sold then to retail customers) or on behalf of particular customers. Thus, "all firm customers of the releasing pipelines have an opportunity to benefit from lower gas prices whether or not they serve industrial loads."\textsuperscript{106} In February 1985, the FERC denied the request of

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\textsuperscript{104}(...continued) Extending Limited-Term Abandonments, and Establishing Procedures, 28 FERC para. 61,383 (Issued September 26, 1984).
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\textsuperscript{105} Ibid., pp. 61,685-61,686.
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\textsuperscript{106} Ibid., p. 61,686. In December 1984, the FERC issued a follow-up order clarifying some points and making some modifications in the program. The Commission declined to take a suggestion by the MPC to require pipelines to provide nondiscriminatory access to transportation as part of the special marketing programs. The Commissioners were not confident that they had the authority to require pipelines to offer such access to their facilities. They also thought that that type of stipulation might be counterproductive as less gas might be moved as a result of it. See Tenneco Oil Company, Houston Oil & Minerals Corporation, Tenneco Exploration, Ltd., Tenneco Exploration II, Ltd., Tinco, Ltd., and Tenneco West, Inc., Docket Nos. CI83-269-000 and CI83-269-024 through CI83-269-034, et al.; Order Granting in Part and Denying in Part Rehearing, Clarifying Certificate Order and Granting Intervention, 29 FERC para. 61,334 (Issued December 21, 1984).
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the Maryland People's Counsel for a stay of this September 1984 or-
der.107

The Maryland People's Counsel Decisions

As shown above, the Maryland People's Counsel (MPC) intervened at various times during the formation and the implementation of the special marketing program policy. The main argument of the MPC was that the SMP policy was anticompetitive and harmful to the captive customers of the participating pipelines. The FERC disagreed and proceeded with the policy, arguing that in any event the SMPs constituted an experiment and might be altered eventually. While the MPC was not as involved in the blanket certificate program, it was one of the parties seeking rehearing of those orders as well.

The MPC took its arguments to the U.S. Court of Appeals for the District of Columbia. The result was three rulings in the spring and

107 Tenneco Oil Company, Houston Oil & Minerals Corporation, Tenneco Exploration, Ltd., Tenneco Exploration II, Ltd., Tinco, Ltd., and Tenneco West, Inc., Docket Nos. CI83-269-000 and CI83-269-024 through CI83-269-034, et al.; Order Denying Motion for Stay, 30 FERC para. 61,202 (Issued February 26, 1985). The MPC argued that the SMPs were anticompetitive because they eased any pressure that pipelines (and indirectly producers) would have otherwise felt to reduce prices in order to retain customers with alternative fuel capabilities. The Commission responded that the MPC had ignored the significance of its decision to include ten percent of firm customers' entitlements in the special marketing programs. This change in the overall policy allowed all end-users to benefit. See p. 61,411.

The Commissioners also asserted that the special marketing programs could not be viewed in isolation. The other programs undertaken by the FERC, such as blanket certificates, encouraged competition and enabled all customers to benefit. The Commissioners concluded that if they granted the People's Counsel's request for a stay, "the benefits of these programs [SMPs] would be lost, perhaps permanently, with resulting harm to consumers and to the industry." See p. 61,412.
summer of 1985 that had a major impact on FERC gas transportation policy and enabled the Commission to pursue the more sweeping initiatives embodied in Order No. 436.

The first two decisions were handed down in May 1985. In *Maryland People's Counsel v. FERC* *I (MPC I)*, the court ruled on the validity of the original Columbia Gas special marketing program that had been approved by the FERC in November 1983.\(^{108}\) The judges stated that they were not ruling on the Commission's authority to approve special marketing programs, but rather on the Commission's power to exclude captive customers or core markets from such programs.

The opinion included a discussion of several Commission reasons, taken from the SMP orders, for deciding not to strike the restriction on captive customers. The first such reason was that ineligible customers would still benefit from a reduction in their share of the pipeline's fixed costs. If the program increased the amount of gas transported (and retained some contribution by fuel-switchable customers to cover pipeline costs), the costs could be spread over that larger volume of gas, thus reducing the amount that each customer would have to bear.

The court labeled this argument the "cost spreading rationale" and did not find it to be persuasive. Echoing the MPC, the judges questioned why such savings to captive customers would not occur if those customers were allowed to participate in the SMP. According to the court, "additional SMP sales would presumably still occur, and fixed costs would still be spread to the benefit of captive customers."\(^{109}\)

The second major Commission argument, labeled "enhancement of pipeline competition," was that competition between pipelines for each

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\(^{108}\) *Maryland People's Counsel v. Federal Energy Regulatory Commission, 761 F.2d 768 (D.C. Cir. 1985).*

\(^{109}\) Ibid., p. 775.
other's core markets might not be in the public interest. A pipeline had made commitments for gas and investments in equipment to serve core markets and if it lost such a market it would have to recover those costs from its other core customers. This cost shifting could be unduly discriminatory, but failure to recover these expenses might jeopardize the pipeline financially and lower the reliability of service to the other customers. This was the Commission's rationale in its order of January 1984, as noted above.

The court also found this rationale unpersuasive. According to the judges, it was not necessary to exclude core markets entirely from the program in order to avoid the competition for those markets that the Commission feared. A pipeline could have been allowed to transport gas released from its system supply to its own captive customers. The FERC might have been justified in limiting competition between pipelines, but there was no justification offered for limiting competition between producers (i.e. between sources of gas) within a pipeline's service area.\(^{10}\)

The third major Commission argument, labeled the "other dockets rationale," was that the points raised by the MPC would be considered in other dockets and subsequent proceedings dealing with the Columbia program. The court noted, however, that the Commission's lawyers could not find another docket in which the People's Counsel's arguments were being addressed. The Commission's "Fabian approach" was unacceptable.\(^{11}\)

The fourth and final major Commission argument discussed in the opinion was labeled the "experiment rationale." The Commission had

\(^{10}\) Ibid., p. 778.

\(^{11}\) Ibid. Citation omitted.
undertaken an experiment in the special marketing programs, and it was not possible at the time to assess its full impact. An experiment was unpredictable. Core markets were not included, but the program was a major departure from existing regulatory policy. The experiment would have to be limited for the time being.

The court stated, however, that there were reasonable experiments and arbitrary experiments just as there were reasonable programs and arbitrary programs. The law required the Commission in responding to major objections to state why it felt that more good than harm would result from its actions, but the FERC had not done so. The MPC had argued that the Commission's departure from existing regulation was counterproductive and would harm the customers, vulnerable to pipeline monopoly power, that the Natural Gas Act was intended to protect. The judges stated that "it is no response to say that for the moment the experiment is 'carefully circumscribed' to help those who do not need the Commission's protection while hurting those who do."\(^{112}\)

The court decided that the original Columbia SMP order was invalid. However, that order had expired by the time that the \(MPC\) opinion was issued and successor orders (the omnibus order of September 1984) had been put into effect. As those orders were also being challenged (in the \(MPC\) III case), the court ordered the Commission to show why the newer orders should not be vacated and remanded to the FERC for reconsideration.

In \textit{Maryland People's Counsel v. FERC II (MPC II)}, issued the same day as the \(MPC\) I decision, the court ruled on the validity of the blanket certificate orders, Order Nos. 234-B, 319, and 319-A.\(^{113}\) The

\(^{112}\) Ibid., p. 779.

arguments made by MPC against the blanket certificates were similar to those it had made against the special marketing programs. Pipelines would keep their rates reasonable only because of the threat of losing large industrial customers who had the capability to switch fuels. Under the law, a pipeline could not lower its rates to those large customers without lowering its rates to all customers because it could be charged with discrimination.

The blanket certificate program as structured, however, allowed a pipeline to transport lower priced gas from producers to the fuel switchable end-users, keeping those customers on the pipeline’s system. Because the same service was not provided to the captive customers, the program removed any competitive check on pipeline rates. The Commission should have conditioned blanket certificates on nondiscriminatory access for captive and noncaptive customers. In that way, the captive customers would not be exploited.\(^\text{114}\)

The court considered the Commission’s arguments, taken from Order No. 319-A, as to why it was unconvinced by the MPC objections. The first was the cost spreading rationale, described above in the MPC I case, that the program would keep the fuel-switchable customers on the system. Those customers would continue to pay a share of the pipeline’s fixed costs, benefiting all customers. The court dismissed this argument in the same manner as it had in the first case, stating that the FERC had not explained why those benefits would not be available if captive customers were included in the program.

Another Commission argument was that the blanket certificate program was designed to encourage pipelines to purchase gas so as to keep their delivered prices competitive. This incentive would result from end-users purchasing gas from other sources besides distributors or

\(^{114}\text{Ibid., pp. 784-785.}\)
pipelines. The judges failed to see what incentive would be created when pipelines could use transportation of direct-sale gas and the special marketing programs to satisfy their fuel-switchable customers.

The court vacated the blanket certificate orders to the extent that transportation of direct-sale gas was provided for fuel-switchable, non-high-priority end-users but not for local distributors and captive customers. The judges instructed, "on remand, FERC should fully consider and reasonably analyze the competitive concerns advanced here by MPC."\(^{115}\)

The opinion in *Maryland People's Counsel v. FERC III* was issued in August 1985.\(^{116}\) In this third case, the judges ruled on the successor special marketing program orders which had allowed limited participation by firm customers, deciding that the FERC had still failed "to come to grips with highly relevant considerations" raised by the MPC.\(^{117}\)

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\(^{115}\) Ibid., p. 789. Several weeks later, on June 28, 1985, the D.C. Court granted a stay of its decision in *Maryland People's Counsel v. FERC III*, which would have gone into effect on July 1, 1985. The Commission had applied for the stay to avoid disruption of ongoing transportation arrangements while it proceeded with the rulemaking covering such transactions. It asked for an extension of the blanket certificate program until October 31, 1985 or until the effective date of a final rule in Docket No. RM85-1-000 (Order No. 436 discussed in the next section), whichever was earlier. The court noted that the MPC did not oppose the stay "... provided that it is secured against use as a wedge for an even longer period of tolerance for discriminatory transportation programs." While the court approved the stay until the deadlines requested by the FERC, it also stated that no further extensions would be granted. See *Maryland People's Counsel v. Federal Energy Regulatory Commission*, 768 F.2d 1354 (D.C. Cir. 1985).


\(^{117}\) Ibid., p. 452.
In the view of the judges, allowing firm customers to nominate up to ten percent of their contractual entitlement to be purchased in an SMP still permitted substantial discrimination. The court was not willing to accept the Commission's arguments that more restructuring of the gas market beyond that in the SMP order could result in adverse cost shifting and that including captive customers may have led to less transportation of SMP gas.

In concluding, the judges stated that "...we are persuaded that the new SMP orders are of a piece with the old. ...They may be marginally less discriminatory than their predecessors, but they continue to entail identical lapses of logic and evidence." However, because the orders were to expire on October 31, 1985, the court concluded that it would be better to allow them "to die a natural death." But, the judges added, "if the Commission wishes to retain discriminatory SMPs in some form after October 31, we trust that it will do so only if it can demonstrate that the petitioners' concerns are unfounded or are outweighed by other relevant considerations."118

First Commission Response: FERC Order No. 436

The process resulting in Order No. 436 began at least several months before the MPC cases were decided. Thus, in a sense, it is inaccurate to say that Order No. 436 was intended solely as a response to those court decisions. However, in the MPC decisions the judges imposed a deadline of October 31, 1985 on the Commission forcing the FERC to move ahead more quickly with the course that it had begun to pursue and helping to justify certain subsequent Commission policies.

118 Ibid., p. 455.
The FERC issued two Notices of Inquiry (NOI) in late 1984 and early 1985. In the first NOI, dated December 24, 1984,\textsuperscript{119} the Commission stated that its aim was to "elicit constructive and thoughtful discussion" on restructuring its Natural Gas Act mandated regulation of interstate transportation of gas so that "the natural gas market becomes a viable and competitive market in which consumers are provided adequate supplies of gas at the lowest reasonable cost."\textsuperscript{120} Among the questions raised was one on what the effects would be of making core market sales subject to competition by alternate sellers.\textsuperscript{121}

On May 30, 1985, approximately three weeks after the first two Maryland People's Counsel decisions, the FERC issued a Notice of Proposed Rulemaking.\textsuperscript{122} The Commissioners observed that they had begun receiving "the guidance of reviewing courts" ruling on some of the policies that the FERC had pursued in the previous one and one half years.\textsuperscript{123}

\textsuperscript{119} Interstate Transportation of Gas for Others; Notice of Inquiry; Docket No. RM85-1-000; Issued December 24, 1984, 50 Fed. Reg. 114 (January 2, 1985).

\textsuperscript{120} Ibid., p. 116.

\textsuperscript{121} The second NOI, issued in January 1985, included questions relating to ratemaking and the risk and financial implications of partial wellhead decontrol. The Commission stated its concern that its current policies might be hindering competition and described factors of increasing importance in ratemaking. See Natural Gas Pipeline Ratemaking, Risk, and Financial Implications after Partial Wellhead Decontrol; Notice of Inquiry; Docket No. RM85-1-000 (Phases II & III); Issued January 18, 1985, 50 Fed. Reg. 3,801 (January 28, 1985).

\textsuperscript{122} Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Notice of Proposed Rulemaking; Docket No. RM85-1-000 (Parts A-D); Issued May 30, 1985, 50 Fed. Reg. 24,130 (June 7, 1985).

\textsuperscript{123} Ibid., p. 24,130. Citation omitted.
The Commission stated that its intent was to make any changes in its regulation of interstate gas transportation that might be required to ensure that gas markets were sufficiently competitive. It sought to identify and adjust any part of its regulations that hindered the development of competition where competition would serve the public interest better than traditional public utility regulation. The goal was that consumers would receive reliable long-term natural gas service at the lowest possible rates.\textsuperscript{124}

The proposed rule included four parts covering transportation, take-or-pay, optional expedited certificates for new services and projects, and a block billing mechanism. The transportation certificate provisions are the most important for considering the response of the FERC to the MPC decisions. The take-or-pay provisions, however, are important for considering subsequent events and court challenges.

With respect to transportation, the Commission proposed that any pipeline seeking a blanket certificate to transport would have to provide such service on a nondiscriminatory basis. Transportation would be offered separately from sales service and would be separately billed. A

\textsuperscript{124} Ibid., p. 24,131. The Commission noted that the commenters responding to the Notice of Inquiry had been "of great help" in identifying areas that might be modified. The responding parties generally felt that transportation programs should be available and should be made permanent. The commenters also thought that in the longer term open access to nondiscriminatory transportation at appropriate rates could be implemented to the extent that there was available pipeline capacity. The FERC would have to give the industry sufficient time to make the change to nondiscriminatory access because it would involve modifying gas purchase contracts, service agreements, and other obligations. See ibid., p. 24,131. This last point is notable given the divisions that occurred later in 1985 at the FERC between those who wanted to give the industry more time to adapt to the changes mandated in the rule and those who wanted a quicker pace. This division is described below in Chapter 4.
customer contracting for firm, uninterruptible service would receive it as long as there was available pipeline capacity. This program would be voluntary and none of these conditions would apply to a pipeline unless it had accepted a blanket certificate.\textsuperscript{125}

The proposed rule also provided for contract demand reduction in an attempt to enable sales customers of the pipelines to participate more fully in the new program. Under this provision, firm sales customers of any pipeline that had agreed to transport gas for other customers under the program would be entitled to reduce the amount of gas that they had contracted to buy from the pipeline (i.e. their contract demand) by up to 25 percent in any one year. The pipeline could allow the customer to reduce its demand by greater than 25 percent. If the pipeline agreed, the customer could reduce its contract demand up to 100 percent. The customer was required to give thirty days' notice to the pipeline.\textsuperscript{126}

The take-or-pay provisions of the proposal were to apply to any pipelines accepting blanket certificates and offering nondiscriminatory access to transportation under the rule. Payments made by pipelines to producers to buy out the minimum payment or purchase obligations of certain of their contracts (agreed to before January 1, 1982 and extending beyond January 1, 1986) with the producers would be assumed prudent for purposes of satisfying the Natural Gas Act.\textsuperscript{127}

The FERC issued Order No. 436 implementing with some modifications the transportation portions of the proposed rule in October 1985. The rule was approved on October 9, three weeks before the deadline

\textsuperscript{125} Ibid., pp. 24,135 and 24,136-24,137. \\
\textsuperscript{126} Ibid., pp. 24,136 and 24,162. \\
\textsuperscript{127} Ibid., pp. 24,132 and 24,166.
imposed by the court for the expiration of the SMP and blanket certificate programs.  

The transportation provisions of Order No. 436 included the requirement of nondiscriminatory access to transportation for those pipelines participating and offering services under the authority of section 7 of the NGA (blanket certificates) or section 311 of the NGPA.

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128 For Order No. 436, see Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Final Rule and Statement of Policy; Docket No. RM85-1-000 (Parts A-D); Order No. 436; Issued October 9, 1985, 50 Fed. Reg. 42,408 (October 18, 1985). At the same time that it issued Order No. 436, the Commission also decided to ask for additional comments on the block billing provisions. See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Proposed Rule and Notice Requesting Supplemental Comments; Docket No. RM85-1-000 (Part D); Issued October 9, 1985, 50 Fed. Reg. 42,372 (October 18, 1985). The block billing proposal and the controversy surrounding it are discussed in Chapters 4 and 5.

On the take-or-pay portion of the proposed rule, the Commissioners noted that most commenters had opposed the presumption of prudence for the one-time payments by pipelines to end contractual payment or purchase obligations. Few commenters supported the proposal as it was written. The Commissioners thus were "persuaded that an attempt to impose a regulatory solution at this time may actually aggravate the situation rather than improve it." See Order No. 436, p. 42,462.

Instead of the NOPR proposal, the Commission decided to reaffirm a policy statement on take-or-pay that it had issued in April 1985. In that statement, the FERC had said that first sellers of gas, such as producers, would not violate the Natural Gas Policy Act (NGPA) requirement that they not receive prices for gas above the NGPA maximum lawful prices when the excess consisted of payments made by pipelines to amend or waive take-or-pay or other minimum payment obligations. The pipeline could then recover the costs of the payments by filing a rate case with the FERC under the Natural Gas Act. See Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations; Statement of Policy and Interpretative Rule; Docket No. PL85-1-000; Issued April 10, 1985, 50 Fed. Reg. 16,076 (April 24, 1985) at 16,077 and 16,080. Pipelines and producers were apparently already using this procedure in their take-or-pay contract renegotiations. See "Commission Supports Payments Made in Lieu of Take-or-Pay Obligations; Statement of Policy Issued," FERC Monitor, April 18, 1985, pp. 1-2.
Transportation service and the allocation of pipeline capacity would have to be furnished on a first-come, first-served basis. There could be no undue discrimination or preference between firm sales and firm transportation service or between interruptible sales and interruptible transportation service.129

The Commission retained the contract demand (CD) reduction provisions of the proposed rule, but added a CD conversion option. While these provisions were not at the heart of the order, CD conversion and reduction are important when considering the subsequent court challenge to Order No. 436. In addition, as discussed in chapter 4, the date when these provisions would become mandatory for pipelines that participated in Order No. 436 became a point of controversy among the commissioners. Thus, they are described briefly here.

The CD conversion provision mandated that a pipeline providing transportation under the rule would be required to allow its firm sales customers to convert their firm sales service to an equal amount of firm transportation service. The customer would be allowed to convert up to 25 percent of its firm sales entitlement to transportation in any twelve month period, although a pipeline could allow a greater percentage to be converted.

Customers could exercise both demand reduction and conversion at the same time, reducing some entitlement to firm sales service and converting some additional sales service to transportation. However, the combination of reduction and conversion in any single year could not

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exceed 25 percent of the customer's total entitlements unless the pipeline allowed a greater percentage.\textsuperscript{130}

The FERC did not mandate that individual NGA section 7 certificates for transportation and sales services were also to be subject to the nondiscriminatory access conditions of Order No. 436. The Commission decided instead to review those certificates on a case-by-case basis to determine whether they were consistent with the objectives of the order.\textsuperscript{131}

The FERC issued several follow-up orders to Order No. 436 in the ensuing months. None of these incorporated fundamental changes into the program set forth in the original order, however, and they are briefly considered here. The first such rule, Order No. 436-A, was approved by

\textsuperscript{130} Ibid., pp. 42,494-42,495. Order No. 436 also provided for grandfathering existing transportation arrangements that had been authorized under NGPA section 311 and the old blanket certificate program. This provision of the order is also important for considering the subsequent court ruling and should be noted briefly. The justification for grandfathering was to provide for "a suitable transition period" to the new transportation program embodied in Order No. 436 and to avoid disrupting service to customers dependent on the old programs. Section 311 arrangements were to continue until their terms expired or October 31, 1987, whichever date was earlier. Blanket certificate transportation for high-priority users was to continue until the certificate expired. While blanket certificate transportation for low-priority users could also proceed, it would have to be nondiscriminatory. See ibid., p. 42,426. As shown below, this difference in the grandfathering treatment of transactions authorized under different statutes (NGPA section 311 and, in the case of blanket certificates, NGA section 7) was particularly troublesome to the court.

\textsuperscript{131} Ibid. The implications of this decision are discussed further in Chapter 4. As shown there, section 7 certificates were used by pipelines to avoid Order No. 436, creating a fair amount of debate and division at the FERC.
the Commission in December 1985 only two months after the approval of
Order No. 436.\textsuperscript{132}

The main modifications to Order No. 436 incorporated in Order
No. 436-A concerned the contract demand reduction/conversion op­
tion\textsuperscript{133} and were intended to ease the transition to the Order No. 436 era
of nondiscriminatory transportation. The Commission extended from
December 15, 1985 to February 15, 1986 the deadline for interstate
pipelines to provide transportation services for local distributors under
the authority of NGPA section 311 without having to offer the CD reduc­
tion/conversion options. The Commissioners thought that it would be
better for the industry to extend the Order No. 436 transition period
through the bulk of the 1985-86 winter heating season to avoid unduly
disrupting transportation arrangements.\textsuperscript{134}

A major change in the CD reduction/conversion process made in
the new order involved the scheduling of the conversion or reduction. In
Order No. 436, the Commission had specified a four-year, 25 percent per
year, change in a customer's firm sales entitlement. A customer could
either convert or reduce that entitlement up to 25 percent in any one year
unless the pipeline allowed a greater amount.

\textsuperscript{132} See Regulation of Natural Gas Pipelines after Partial Wellhead
Deregulation; Docket No. RM85-1-000; Final Rule; Order Granting in
Part and Denying in Part Applications for Rehearing, Denying Petition
for Stay, and Granting Clarification; Order No. 436-A; Issued December

\textsuperscript{133} Ibid., pp. 52,273-52,274.

\textsuperscript{134} Ibid., p. 52,273. The Commissioners stated that nondiscriminatory
access and other Order No. 436 conditions continued to apply to section
311 transactions.
In Order No. 436-A, the Commission mandated a five-year period with potentially varying amounts of conversion or reduction each year.\(^{135}\) The conversion or reduction period would start when the pipeline began or continued transportation under NGPA section 311 or under Order No. 436.\(^{136}\)

The Commission issued Order No. 436-B in February 1986, again postponing the deadline for pipelines to transport gas for their firm service customers without having to offer them the CD conversion/reduction options. The FERC moved the deadline from February 15, 1986 to June 30, 1986 believing that achievement of the goal of a smooth and orderly transition, as stated in Order No. 436-A, would be aided by the extension.\(^{137}\)

Order Nos. 436-C and 436-D were issued in March 1986. In Order No. 436-C, the Commission considered petitions for rehearing by parties,

\(^{135}\) Ibid., p. 52,274.

\(^{136}\) Reductions or conversions would be cumulative so that a customer not taking the full amount of allowed reduction or conversion in one year could in subsequent years reduce or convert the full cumulative amount eligible to be reduced or converted up to that point. In the first year, a customer could reduce or convert up to 15 percent of its firm sales entitlement. In the second year, the customer could reduce or convert an additional 15 percent or a cumulative amount up to 30 percent. In the third year, the customer could reduce or convert an additional 20 percent, or a cumulative amount up to 50 percent of firm sales entitlement. In the fourth year, the customer could reduce or convert an additional 25 percent, or a cumulative amount up to 75 percent. In the fifth year, and thereafter, the customer could reduce or convert an additional 25 percent or a cumulative amount up to 100 percent. The pipeline could allow its firm sales customers to reduce or convert by amounts greater than these.

\(^{137}\) See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket No. RM85-1-000; RM85-1-148; RM85-1-150 and RM85-1-152 (Part A); Order Granting in Part Petitions for Rehearing and Reconsideration; Order No. 436-B; Issued February 14, 1986, 51 Fed. Reg. 6,398 (February 24, 1986) at p. 6,399.
mainly pipelines and their trade group INGAA, claiming that the cumulative nature of the CD conversion/reduction undermined the more gradual schedule adopted in Order No. 436-A. The pipelines argued that a customer could wait until the fourth or fifth year and then reduce demand by 75 to 100 percent. That would be harmful to a pipeline. The Commissioners believed that such a scenario was highly unlikely to occur. They further noted that the right to convert or reduce demand did not belong to all of a pipeline's customers but only to those parties who were already firm sales customers of the pipeline when it accepted a blanket certificate under Order No. 436.  

Among actions taken in Order No. 436-D, of particular relevance here the Commission denied a petition for rehearing of Order Nos. 436-A and 436-B from the Maryland People's Counsel. MPC argued that a recent Commission order allowing the pipeline Texas Gas to provide interruptible service to fifty-two customers through NGA section 7(c) certificates had rendered Order No. 436 "meaningless." The Commissioners stated that they "would be hard put to disagree more fully with MPC on this issue." The Texas Gas authorization involved transportation provided under the old blanket certificate and SMP programs. In the order for that pipeline, the Commission "acknowledged our concern regarding the potential for undue discrimination...." Texas Gas, however, had pledged not to refuse access to other customers and to apply for


necessary authorization to serve those parties. In addition, no parties had claimed undue discrimination or had protested the proposal. The Commissioners further noted that Order No. 436 was a voluntary program and that the Commission had said that it would continue to review "carefully" section 7 applications as an alternative to that program. Thus, Order No. 436 was "unimpaired" by the Texas Gas decision.¹⁴⁰

As shown in the above summaries of the follow-on orders to Order No. 436, an issue that arose frequently was the date when the contract demand conversion/reduction options had to be offered by pipelines to their firm service customers. As noted, the Commission delayed that date in Order Nos. 436-A and 436-B, believing that the delays were needed to guarantee a smooth transition to the new market order. The Commissioners further pushed back the trigger date in other orders that were not part of the Order No. 436 sequence and these are described below.

After the delay in Order No. 436-B, the Commission then approved orders in individual pipeline cases, moving the CD conversion/reduction deadline to the end of 1986. The FERC next issued an order in early December 1986 covering many of the major pipelines. The Commissioners pushed the date back to May 1, 1987 or ten days after the approval of the first rehearing order on a pipeline's blanket certificate application or plan to implement Order No. 436, whichever came first. The Commissioners stated that this delay was necessary because of the large amount of time needed to process Order No. 436 filings. They also noted that the

¹⁴⁰ Ibid., p. 11,570. See also Texas Gas Transmission Corporation, Docket No. CP86-143-000; Order Granting Certificate, 34 FERC para. 61,203 (Issued February 14, 1986). The use of section 7(c) certificates by pipelines to avoid Order No. 436 is discussed further in Chapter 4.
first rehearing order was specified so that pipelines would not be able to extend the deadline by filing a petition for another rehearing.\textsuperscript{141}

In an April 1987 order, the FERC again extended the deadline for many of the major pipelines. The reasoning was similar: more time was needed to process the Order No. 436 filings. However, the Commissioners did not set a general deadline for all pipelines. Instead the new date was to be thirty days after the FERC issued the first rehearing order on a pipeline's plan to implement Order No. 436 or its blanket certificate application. The first rehearing order was specified for the same reasons as before.\textsuperscript{142}

\textit{AGD v. FERC}

The court challenge to Order No. 436 was initiated by the Associated Gas Distributors (AGD) in the U.S. Court of Appeals for the District of Columbia Circuit. The opinion of the three judge panel in \textit{Associated

\textsuperscript{141} The individual pipeline orders were mentioned by the Commission in testimony to Congress. See U.S., Congress, House, Committee on Energy and Commerce, \textit{Oversight of FERC, Hearing Before the Subcommittee on Energy and Power}. 100th Cong., 1st sess., 1987, p. 100. See also "10 Gas Pipelines Granted Waivers under Order 436," \textit{FERC Monitor}, July 10, 1986, pp. 1, 5; and "Four More Companies Granted Order No. 436 Gas Transportation Waivers," \textit{FERC Monitor}, October 30, 1986, p. 8. In these orders, issued in June and September 1986, the Commission waived the contract demand modification requirements until the earlier of January 1, 1987 or thirty days after the Commission had acted on a company's Order No. 436 blanket certificate application or rate case settlement involving the rule. The December 1986 order is Texas Eastern Transmission Corporation, Docket No. RP86-110-001 et al.; Order Extending Waivers, 37 FERC para. 61,217 (Issued December 8, 1986).

\textsuperscript{142} See Texas Eastern Transmission Corporation, Docket No. RP86-110-001 et al.; Order Extending Waivers, 39 FERC para. 61,027 (Issued April 17, 1987).
Gas Distributors v. FERC was issued in June 1987. The judges essentially upheld the rule but remanded it back to the Commission to consider certain issues.\textsuperscript{143} The opinion was a lengthy discussion of the rule and various side issues. Three main topics are covered below: Commission authority to require open access, contract demand modification, and producer-pipeline contracts/take-or-pay.

The judges first discussed the open access requirements of Order No. 436, describing arguments by some pipelines and other parties that these provisions went beyond the Commission's authority. The court examined the relevant statutes beginning with the Natural Gas Act and the power of the Commission under that law, particularly sections 4 and 5, to deal with undue discrimination. While Congress gave the Commission the power and duty to eradicate undue discrimination, it was alleged by parties to the case that the Commission's attempted exercise of that power in Order No. 436 was invalid because the open access requirement was equivalent to the imposition of common carriage. Congress had not imposed common carriage whereby the pipelines would have to accept gas from all shippers and had not authorized the Commission to do so. The judges stated that this argument "turns statutory construction upside down, letting the failure to grant a general power [imposition of common carriage] prevail over the affirmative grant of a specific one [eradication of undue discrimination]."\textsuperscript{144}

The court noted that the Commission had found that pipelines possessed substantial market power and had denied consumers access to gas at the lowest reasonable costs. The judges referred to the Maryland

\textsuperscript{143} Associated Gas Distributors v. Federal Energy Regulatory Commission, 824 F.2d 981 (D.C. Cir. 1987).

\textsuperscript{144} Ibid., p. 998.
People's Counsel II decision on the old blanket certificate program, stating that

Our holding in MPC II obviously did not require the Commission to make the findings that it has. It surely carried the implication, however, that if it did make supportable findings of undue discrimination in pipeline use of the old blanket certificates, it would have the authority to employ suitable remedies. And it carried the further implication that among them might be a requirement that any pipeline offering blanket-certificate transportation agree to serve "LDCs and captive consumers on non-discriminatory terms."  

The MPC II decision "came about as close to endorsing the Commission's approach as Article III permits."  

In summarizing the case under the NGA, the court noted that section 5 empowered the FERC to "stamp out" undue discrimination, that section 7 allowed the Commission to attach reasonable terms and conditions to certificates of public convenience and necessity, and that section 16 authorized the FERC to take the actions needed to implement the law. Thus, the "alleged negative restriction on this power is at best ambiguous, if indeed it exists at all." The Commission's interpretation of its powers under the NGA was reasonable and the court was bound to uphold it.

\(^{145}\) Ibid. Reference omitted.  

\(^{146}\) Ibid.  

\(^{147}\) Ibid., p. 1001. The judges then examined the Natural Gas Policy Act and the argument that section 602 of that law prohibited the imposition of common carriage and thus any effort by the Commission to require nondiscriminatory access. Under NGPA section 311, the Commission could authorize interstate pipelines to transport gas on behalf of intrastate pipelines or local distributors. In addition, intrastate pipelines could be authorized to carry gas on behalf of an interstate pipeline or a

(continued...)

223
In analyzing contract demand modification the court found that those provisions ran afoul of its 1979 Panhandle ruling. The Commission argued that an application for a blanket certificate under Order No. 436 was voluntary and thus the FERC was not mandating change in previously approved rates. The court responded, however, that this point was not valid because legally speaking all section 7 applications were voluntary. The Commission also argued that it was invoking its authority under section 7(b) of the NGA to allow companies to abandon certificated services. The court stated that the Commission's abandonment

147(...continued)

local distributor served by an interstate pipeline. Section 602 mandated that common carriage could not be imposed under federal or state law on any pipeline transporting under section 311 authorization. The court stated that the petitioners' interpretation of the section 602 prohibition was not correct. Congress was trying to prevent state authorities and not the FERC from imposing common carriage on pipelines. Increased state regulation would have discouraged pipelines from transporting under section 311 and thus defeated the statutory purpose of encouraging the development of a national gas transportation network. On the other hand, "a duty not to discriminate, imposed by the Commission on the basis of findings that the duty is necessary to assure consumers access to competitively priced gas, is utterly different" and would help to accomplish the objectives of Congress. See p. 1002.

148 In Panhandle Eastern Pipe Line Company v. FERC, the court had limited the power of the FERC to attach conditions to NGA section 7 certificates. The judges ruled that the FERC, in approving a section 7 certificate, could not alter established rates for customers who would not be receiving the services being certified in that section 7 proceeding. Such an exercise of power under section 7 would circumvent the Commission's responsibilities under NGA section 5. Section 5 specified procedures for the FERC to follow to establish just and reasonable rates itself when it found a pipeline's rates to be unjust. See Panhandle Eastern Pipe Line Company v. Federal Energy Regulatory Commission, 613 F.2d 1120 (D.C. Cir. 1979). This decision was also very important in the disposition of the Northern Natural case and is discussed more fully in that section. 224
authority applied only to the pipeline's obligation to serve and could not be used to relieve customers of their requirements under contracts.

The Commission could have used section 5 of the NGA to excuse customers from their contracts but had not done so. Because the FERC had not used section 5 and because the voluntariness and section 7(b) abandonment arguments were not sufficient, the judges found that the contract demand modification provisions did not have a basis in the law to the extent that blanket certificate transportation under the NGA was conditioned on release of customers from contract obligations. The Commission could apply CD adjustment to transportation under section 311 of the NGPA (where Panhandle was inapplicable) and the judges then examined CD conversion and reduction in light of that statutory provision.149

In considering contract demand conversion, the judges observed that "unilateral abrogation of a contract is an extreme measure. This is true even where the abrogation is partial, as it is under the conversion option...."150 However, the court found the Commission's rationale for CD conversion persuasive even though it denied the pipelines the benefits of their contracts. Pipelines were so deprived only because the agreements were the "vestiges of their monopoly power" and CD conversion was intended only "to correct the consequences of that power." Such action by the FERC complied with the purposes of the NGPA and the Commission was thus correct in applying CD conversion to transportation under section 311.151

149 AGD v. FERC, pp. 1014-1015.

150 Ibid., p. 1016.

151 Ibid., pp. 1017-1018.
The court found, however, that the FERC had not developed an adequate justification for contract demand reduction. The judges noted that CD reduction had been proposed in the notice of proposed rulemaking but that CD conversion had not. But "when the Commission later recognized and embraced CD conversion, its analysis of CD reduction became largely obsolete." The FERC had continued to argue that CD reduction was necessary to assure customers access to competitively priced gas. However, the court believed that the reduction option was no longer needed because conversion was available.\footnote{Ibid., p. 1018.}

With respect to producer-pipeline contracts and take-or-pay, the judges began by identifying the problem for the industry as the combination of contractually mandated prices that were much higher than the current market levels with take-or-pay clauses requiring a pipeline to buy a specified percentage of a producer's gas or to pay for that percentage anyway. They noted that almost every party except producers had criticized the Commission's lack of action on contracts in Order No. 436. The main argument of those seeking FERC action was that Order No. 436 had not given pipelines leverage in bargaining with producers because a pipeline could not refuse to transport a producer's gas even when the producer did not compromise on the pipeline's contract liabilities.

The judges considered the various reasons offered by the FERC for not acting on the contracts. One of the main issues here was the Commission's decision not to condition producers' access to transportation on their cooperation in solving take-or-pay problems. The Commission argued that such conditioning would have been discriminatory not only against the producer but also against the potential buyer of the gas. The court found this to be an unsatisfactory explanation. The FERC had stated to the court that the contracts were a main cause of the problems.
that the Commission was trying to resolve with Order No. 436. Thus, pipeline denial of access to producers who were trying to enforce those contracts would not have been unduly discriminatory.\footnote{Ibid., p. 1029.}

The judges found that the Commission's decision not to act on the pipeline-producer contracts was based on questionable legal and factual conclusions. Because the policy issues involved were crucial, the court remanded the decision in order for the FERC to reconsider whether the policy considerations justified inaction. The judges stated that "we do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking."\footnote{Ibid., p. 1030.}

Thus, the court upheld the substance of Order No. 436 but found problems in a few of the rule's components. These included the lack of a legal basis for the contract demand modification provisions, the absence of a sufficient rationale for contract demand reduction, and the failure to explain adequately the decision not to act on producer-pipeline contracts. Because the various components of Order No. 436 were interdependent, the judges decided to vacate the rule and remand it to the Commission for action consistent with its decision.\footnote{Ibid., p. 1044. The court was also concerned with the grandfathering provision of Order No. 436 because it would permit transactions considered unlawful to extend well into the 1990s.}

Perhaps these are rare enough, or involve so little volume, that the grandfathering will only trivially encourage pipeline resistance to the concept of nondiscrimination. Or perhaps the equities of the participants are stronger than appear. We cannot, however, "discern the path" by which the Commission has reconciled such grandfathering to its acknowledged mandate to stamp out discrimination.

(continued...)
Second Commission Response: Order No. 500

The immediate response of the FERC to the AGD ruling was to issue an order in July 1987 staying the effectiveness of the contract demand modification regulations until the Commission could act "in a more dispositive manner" on the issues of concern to the court. In August 1987, the FERC issued Order No. 500 which was intended to be an interim response while the Commission began a thorough examination of the problems found by the court in Order No. 436. In Order No. 500,

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\(^{155}(...continued)\)

See ibid., p. 1041. Reference omitted. The Commission's explanation for the grandfathering was that it would help insure a smooth transition to the new market and regulatory framework of Order No. 436. Parties to those transactions depended on the transportation and the FERC did not want to infringe on them. However, the Commission also admitted that grandfathering would relieve pressure on the pipelines to embrace the rule. In the view of the court, the Commission's justifications for grandfathering did not seem "to meet the modest standard implicit in the concept of reasoned decisionmaking." See ibid. Reference omitted.

The court also was not satisfied with the Commission's different treatment in Order No. 436 of transactions authorized under NGA section 7 and NGPA section 311. While section 7 transactions would be allowed to run their full terms of five and ten years, section 311 agreements were only authorized to continue until the earlier of the expiration date or two years after the effective date of Order No. 436. The judges, who were not content with grandfathering in the first instance, stated that this different treatment of section 7 and section 311 agreements "deepens our mystification." See ibid., p. 1042.

\(^{156}\) See Natural Gas Pipelines after Partial Wellhead Decontrol; Docket No. RM85-1-000; Order Staying Effectiveness of Regulation; Issued July 2, 1987, 52 Fed. Reg. 27,798 (July 24, 1987) at p. 27,799.
the Commission reinstated much of the framework of Order No. 436 with some modifications.\textsuperscript{157}

One such change was the decision to drop the CD reduction option. The Commission stated that the objectives of reduction were still valid, but that there was not enough time in the interim proceeding to develop a sufficient record to justify it. The Commissioners believed that the benefits of reduction (greater access for customers to alternative supplies) would be attainable through the use of CD conversion, which was being retained, and through open access transportation. The Commissioners also held out the possibility that they would order CD reductions for a particular pipeline if complaints or a Commission investigation showed that such action was warranted.\textsuperscript{158}

The major modification to the Order No. 436 program made by the Commission in Order No. 500 was in the area of take-or-pay.\textsuperscript{159} The Commissioners noted the complexity of this problem and stated that all segments of the industry shared some responsibility for it. Thus, all segments would have to bear some of the burden of resolving it.

The Commission had decided in Order No. 436 that it would be undue discrimination for a pipeline to refuse to transport a producer’s gas.\textsuperscript{160} In the \textit{Associated Gas Distributors} ruling, the court expressed


\textsuperscript{158} Ibid., pp. 30,347-30,348.

\textsuperscript{159} Ibid., pp. 30,337-30,347.

\textsuperscript{160} In Order No. 436, the Commission discussed the suggestion made by many pipelines that it condition producer access to transportation on producers’ willingness to waive their rights under take-or-pay provisions. (continued...)}
concern that this decision had taken some bargaining power away from the pipelines in negotiations with producers over take-or-pay.

In response to the court's concern, the Commissioners decided to establish a system of transportation credits. Under this system, a pipeline could refuse to carry a producer's gas unless the producer offered to credit the transported fuel against the pipeline's take-or-pay liability to the producer.\textsuperscript{161} A pipeline having more than one contract eligible for credits with a particular producer could choose the agreement to which it would apply the credits. The Commission recognized that the different contracts might have different pricing and take-or-pay stipulations. The pipeline could apply the credits as if the gas was purchased in the contract year or in any previous year back to January 1, 1986 in which the carrier was open access. This provision of the rule, referred to as

\textsuperscript{160}(...continued)
The Commissioners asserted that transportation was to be available on an equal and nondiscriminatory basis. Thus, "we cannot allow some shippers to be 'more equal' than others." Conditioning access would "run completely counter to the whole idea of opening up the transmission grid on a non-discriminatory basis...." \textsuperscript{161} See Order No. 436 at 50 \textit{Fed. Reg.} 42,433-42,434.

\textsuperscript{161} Order No. 500, p. 30,338. For each unit transported, the pipeline would receive credit as if: first, it had purchased the gas under a contract dated before June 23, 1987 and second, it had made the purchase in the contract year that the gas was transported or any previous year in which the pipeline was open access back to January 1, 1986. The date of June 23, 1987 was the date of the \textit{AGD} ruling and a time by which the Commission felt that pipelines would no longer be agreeing to uneconomic take-or-pay agreements.

The Commissioners specified two categories of gas for which pipelines would not receive credits for transportation. The first was gas not currently committed to the pipeline by contract but which the pipeline had previously purchased under a contract that had since expired. The second was gas released from a contract containing a provision (a market-out clause) allowing the pipeline to end the agreement when it so chose.
cross-crediting, generated substantial controversy among the commissioners, as described in Chapter 4. Transportation that occurred before the effective date of Order No. 500 would not generate any credits.\textsuperscript{162}

The FERC issued several follow-on orders to Order No. 500 during the remainder of the Reagan administration. The main provisions of some of these can be mentioned briefly. The Commission issued Order No. 500-B in October 1987, granting producers' request to stay the crediting provision. The Commissioners decided to delay from September 15, 1987 to January 1, 1988 the date by which producers had to offer pipelines take-or-pay credits in order to have their gas transported. The Commissioners also extended the stay of the CD conversion procedure to January 1, 1988. These changes were necessary "to accommodate the industry's need for additional time" to adjust to Order No. 500.\textsuperscript{163}

\textsuperscript{162} Ibid., p. 30,339-30,340. Grandfathering was an area where the FERC decided that no change was needed and reissued the regulations from Order No. 436. The Commissioners believed that grandfathering did not dissuade pipelines from accepting the nondiscriminatory requirement of Order No. 436. Only a relatively small amount of gas was being transported under the grandfathered transactions and most of the pipelines involved had already participated in Order No. 436. See Order No. 500, pp. 30,349-30,350.

The Commission also reaffirmed its decision to allow the NGA section 7 authorized transactions to continue to operate until their expiration unlike the NGPA section 311 transactions which had been limited to two years after the issuance of Order No. 436. Many of the section 7 transactions had resulted from Commission policies intended to avoid a repeat of the gas shortages that plagued the interstate market in the late 1970s and early 1980s. For that reason and because of the desire to avoid creating hardship for the parties involved, the FERC weighed the benefits of grandfathering against the "slight incentives" that ending grandfathering would provide a pipeline to participate in Order No. 436 and decided that the transactions would be allowed to continue.

\textsuperscript{163} See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket Nos. RM87-34-001 through 052; Order Denying (continued...)

231
In Order No. 500-C, approved in December 1987, the Commission decided that credits should not be applied to gas from new wells (wells drilled after June 23, 1987). Producers had argued that they would have less incentive to explore for and produce new gas reserves if transportation of the new gas would then result in credits against a pipeline's take-or-pay requirements for existing gas supplies. The Commissioners believed that only a small amount of the gas that would be produced in the several following years would come from wells drilled after June 23, 1987. Thus, the effect of the exemption for new gas would not be great with the benefits outweighing any reduction in pipelines' take-or-pay relief.

The Commissioners also denied various requests for a stay of the crediting provisions at least until after the winter of 1987-88 had passed. They noted their conclusion that the FERC "has an obligation under AGD and related court orders to implement the interim procedures for take-or-pay crediting on January 1, 1988."

The response of the FERC to the MPC/AGD court orders, as with the Mid-La and INGAA cases, appears to contain elements of both implementation and evasion. With respect to MPC, the Commissioners

163 (...continued)

164 See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket Nos. RM87-34-000 through RM87-34-054; Order on Rehearing Modifying Prior Orders and Requesting Comments; Order No. 500-C; Issued December 23, 1987, 52 Fed. Reg. 48,986 (December 29, 1987) at p. 48,987.

165 Ibid., p. 48,988.

166 Ibid., p. 48,990.
provided for nondiscriminatory transportation in Order No. 436 although vigorous implementation was held back by the Commission’s cautious interpretation of its powers and, as discussed more fully in Chapter 4, its felt need to avoid disrupting the gas industry. The program was voluntary (as were the special marketing and blanket certificate policies replaced by Order No. 436) and section 7 certificates were available to pipelines as a way of avoiding the open access embraced by the court and required by Order No. 436. In addition, the FERC continued to postpone the full operation of the contract demand modification provisions. One might certainly argue over whether these latter facts constitute evasion or caution (or most likely evasion due to caution), however in MPC, the court and the Commission were moving in basically the same direction.

In the AGD case, the FERC did respond to the judges’ concerns about take-or-pay and problem contracts. Crediting might have been a more conservative approach instead of the contract abrogation advocated by some. However, the FERC provided a mechanism for dealing with take-or-pay and thus appeared to be implementing the judicial mandate to act on the contracts despite the arguments about the efficacy of the chosen method.

**The Northern Natural Case**

This case involved the authority of the FERC to place conditions on a pipeline’s certificate of public convenience and necessity. These certificates, granted by the Commission to a pipeline under section 7(c) of the Natural Gas Act, authorize specific transactions and enable a pipeline to transport gas in interstate commerce. While the initiatives undertaken by the FERC in the 1980s allow pipelines to transport without having to obtain authorization for each transaction (i.e. Order No. 436 and blanket certificates which are actually authorized under section 7),
section 7 certificates remain as an important alternative to Order No. 436. The NGA empowers the Commission to place any reasonable terms and conditions on a pipeline's certificate as it may feel are warranted by the public convenience and necessity. That part of the Commission's power was at the heart of the controversy involving Northern Natural.

In one sense, this case represented a clash between the interests of different customer classes: noncaptive fuel-switchable customers who would benefit from the discount rates offered by the pipeline versus the captive customers who would not receive the discounts. More importantly, the case was a confrontation between the FERC and the court over a judicially-imposed restriction on Commission power.

**FERC Policy Decisions**

In October 1982 Northern Natural Gas Company filed for a certificate of public convenience and necessity under section 7(c) of the NGA. Northern wanted to provide service under two new rate schedules intended to price gas more flexibly to compete with the prices of alternative fuels. Northern hoped to serve customers who would have switched to oil if its gas were priced under Northern's usual rate schedules.

The Commission expressed some doubts and concerns about the proposed marketing program, noting that it may not have been the best way for the pipeline to deal with the current market conditions. However, the Commissioners also found that Northern Natural was vulnerable to market loss to alternative fuels and so they approved a temporary six month certificate for the program in December 1982. At the same time,
they decided that the case should have a formal hearing before an admin-
istrative law judge.\textsuperscript{167}

Soon thereafter, in February 1983, the Commission rescinded the
temporary certificate that it had issued to Northern Natural. The Com-
missioners agreed with one party requesting rehearing, a distributor that
purchased gas from the pipeline, that Northern had not furnished enough
proof that it was facing a substantial loss of markets to other fuels.\textsuperscript{168}
Northern proceeded to provide the documentation needed to convince
the FERC which granted the pipeline a six month certificate in May 1983
and extended it for another six months in November of that year.\textsuperscript{169}

\begin{itemize}
\item \textsuperscript{167} See Northern Natural Gas Company, Division of InterNorth Inc.,
Docket Nos. CP83-14-000, CP83-14-001, CP83-16-000, CP83-16-001,
CP82-33-002, and CP82-33-005; Order Granting and Denying Temporary
Certificates and Protests, Instituting Proceeding, Consolidating Applica-
tions, and Granting and Denying Motions to Intervene, 21 FERC para.
61,324 (Issued December 22, 1982).
\item The Flexible Pricing-Pipeline Option (FPO) rate schedule was to
apply to Northern Natural's local gas distributor customers and the rates
were to be charged to those utilities' customers who had the capability to
switch fuels. The Large Volume Contract Service (LVCS) rate schedule
was to apply to contracts for gas negotiated by Northern Natural's utility
customers with consumers that had alternative fuel capability and used
more than 199,000 cubic feet of gas each day. See the administrative law
judge's discussion in Northern Natural Gas Company, Division of Inter-
North, Inc., Docket No. CP83-14-000; Initial Decision, 26 FERC para.
63,071 (Issued February 24, 1984) at pp. 65,267-65,268. See also North-
ern Natural's original application as described briefly in Northern Natu-
ral Gas Company, Division of InterNorth, Inc.; Application; Docket No.
\item \textsuperscript{168} See Northern Natural Gas Company, Division of InterNorth, Inc.,
Docket Nos. CP83-14-003 and CP83-14-004; Order Rescinding Temporary
Certificate, 22 FERC para. 61,173 (Issued February 18, 1983).
\item \textsuperscript{169} See Northern Natural Gas Company, Division of InterNorth, Inc.,
Docket No. CP83-14-005; Order Granting Temporary Certificate and
Denying Protest, 23 FERC para. 61,295 (Issued May 27, 1983). The
(continued...)
In February 1984, the administrative law judge issued his decision.\(^{170}\) The judge stated that the major issue for him to decide was whether the benefits of the program to customers both eligible and ineligible to participate outweighed any potential detriments. The judge found that the benefits, including improved recovery of the pipeline’s costs, reduction in the pipeline’s cost of gas, and retention of customers by the local distributors served by Northern Natural, greatly outweighed the costs and he approved the program.

The judge specifically rejected a suggestion that Northern Natural be required to track the sales under the special rates with the purpose of immediately crediting the revenues earned to nonparticipating customers. Northern Natural had cited a 1979 D.C. Court of Appeals ruling, the *Panhandle* decision which is discussed further below, to argue against that option. In that earlier case, the court had ruled on the Commission’s

\(^{169}(...continued)\)

Commission denied rehearing of this order in September 1983. See Northern Natural Gas Company, Division of InterNorth, Inc., Docket Nos. CP83-14-006 and CP83-14-008; Order Denying Rehearing, 24 FERC para. 61,340 (Issued September 26, 1983). One of those requesting rehearing was the Process Gas Consumers Group, a frequent intervenor in the blanket certificate and special marketing program cases. Among its arguments on the Northern Natural program was that it was discriminatory. As described earlier in the section on the *Maryland People’s Counsel* cases and in Chapter 4 below, PGC often made this argument along with the People’s Counsel especially with respect to the special marketing programs. In this instance, the Commission said that the issue was going to be considered in the hearing before the administrative law judge. See 24 FERC at p. 61,726. The extension granted to Northern Natural in November 1983 can be found at Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-014; Order Amending Order Issuing Temporary Certificate and Denying Protest, 25 FERC para. 61,305 (Issued November 25, 1983).

\(^{170}\) See Northern Natural Gas Company, Initial Decision, 26 FERC para. 63,071.
authority to attach conditions to section 7 certificates. It had said that the FERC could not modify previously approved rates that were not before the Commission at the time when deciding on a section 7 certificate. The administrative law judge agreed with Northern Natural, remarking that "in this regard, it appears that Northern's point is well taken and that the crediting mechanism should not be employed."

In May 1984, the Commission issued an order substantially affirming the judge's decision and granting a certificate for the program to continue through October 26, 1984. The Commissioners noted that Northern Natural's customers would benefit because the pipeline would be able to make sales that it would not have otherwise, increasing the recovery of its fixed costs. This benefit would be realized after Northern had filed a new set of rates.

The Commission also stated that because the program departed from traditional gas utility regulation, "we feel obliged to ensure that Northern's customers obtain the appropriate benefits and protection." Many of the benefits from the rates would not be felt by customers until the pipeline's next rate case which might not be for some time. But the Commissioners believed that "the pipeline's non-discount customers

\[171\] Ibid., p. 65,281. With respect to the charge made by the Process Gas Consumers Group that the rates were unduly discriminatory, the judge noted that according to case law only unjustified differences in rates were prohibited. The crucial point was determining whether the rates "are reasonable and whether there is an adequate explanation for different treatment of various customers." Recalling his finding in an earlier part of the opinion that the potential benefits of the rates to Northern and to its customers outweighed the possible harm, the judge stated that the difference in rates thus was justified and was not undue discrimination. See ibid., pp. 65,277-65,278.

\[172\] See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-000; Order Approving Flexible Rates, 27 FERC para. 61,299 (Issued May 25, 1984).
should receive a more immediate benefit." Accordingly the Commission, unlike the administrative law judge, decided to require Northern to credit the fixed costs recovered by the sales under the discount rates to the noneligible customers until the pipeline's next rate case.¹⁷³

Northern Natural applied for a rehearing of the crediting requirement, but the Commission denied the request in August 1984.¹⁷⁴ Northern had argued that the first condition was an illegal expansion of FERC authority under NGA section 7. The pipeline referred to the D.C. Circuit's decision in Panhandle Eastern Pipe Line Company v. FERC.¹⁷⁵ In that case, the Commission had allowed Panhandle to transport gas for an industrial customer but had decided that the pipeline was to pass through the revenues received from the transportation service to customers who purchased gas from it. The court ruled that the FERC could not condition a section 7 certificate in such a manner that it would modify the previously approved rates of customers not receiving the services at issue in the section 7 proceeding.¹⁷⁶

¹⁷³ Ibid., p. 61,554.

¹⁷⁴ See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-039; Order Denying Rehearing, 28 FERC para. 61,230 (Issued August 21, 1984).


¹⁷⁶ In Panhandle, the court said that the Commission's expansive interpretation of its section 7 conditioning power would render powerless other parts of the Natural Gas Act. Section 4 of the Act established procedures for pipeline rate cases. Section 5 empowered the Commission to establish just and reasonable rates for a pipeline itself if it found after a hearing that a pipeline's rates were unjust or discriminatory. The court found that the Commission's use of section 7 in the Panhandle case would "emasculate" the importance of section 5 in establishing rates, arguing that "any time the Commission had good reason to believe that a (continued...)

238
The Commission differentiated the Northern Natural case from *Panhandle*, saying that its decision regarding Northern Natural was not intended to overturn rates previously found to be just and reasonable. Rather, the Commission said that it was just discounting rates to certain customers so that all customers, and not only those eligible to receive the flexibly priced gas, could benefit from the program.\(^{177}\)

In October 1984, the Commission granted a three month extension of the program, until January 26, 1985, while it evaluated the merits. Northern Natural, however, had requested a two year extension. The Commission retained the crediting requirement that Northern found objectionable and denied rehearing of this order in December 1984.\(^{178}\)

One day before the three month extension was to expire in January 1985, the FERC extended the program until October 1985. Northern Natural, however, had requested an extension until October 1986, claiming that regulatory uncertainty was harming the effectiveness of the program. The Commissioners approved the shorter time, noting that the benefit arising from certainty had been Northern's only justification for the longer extension and that the FERC had limited other programs to a one year extension. The Commissioners also observed that Northern had

\(^{176}\)(...continued)

pipeline's rates were unjust or unreasonable, it could simply condition the granting of new certificates on the adjustment of those rates...." There would thus be no need to use the procedures specified in section 5. See the court's discussion in ibid., pp. 1128-1130.

\(^{177}\) See Northern Natural Gas Company, Order Denying Rehearing, 28 FERC para. 61,230 at p. 61,438.

\(^{178}\) See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-040; Order Amending Certificate, 29 FERC para. 61,119 (Issued October 26, 1984); and Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-051; Notice of Denial of Rehearing, 29 FERC para. 61,343 (Issued December 26, 1984).
continued to object to the conditions imposed on the program. As the pipeline had not offered any new arguments to persuade the FERC to change its position, the Commission made no change.\textsuperscript{179}

In October 1985, the FERC decided not to renew the program, denying Northern Natural's request for a two-year extension. By this date, the Maryland People's Counsel cases had been decided and Order No. 436 had been issued. The Commission stated that:

Northern's discount rate program is discriminatory and contains market eligibility restrictions that are similar to those criticized by the court in reviewing special marketing programs and the blanket transportation authorization of Order No. 234-B .... While we think these market restrictions on eligibility for discount sales were justified at the time they were approved, we do not believe the public interest would be served by extending them. In view of the issuance of the final rule (Order No. 436) and the opportunity presented by that rule to pipelines and their customers to deal with the very problems that engendered Northern's

\textsuperscript{179} On October 17, 1984, three months before the FERC issued this latest extension order, Northern had filed a petition with the D.C. Circuit Court of Appeals asking for review of the Commission's May 25, 1984 and August 21, 1984 orders imposing the crediting requirements. In its January 1985 order the Commission said that no change would be made in the requirements pending disposition of the court challenge. See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-047; Order Amending Certificate, 30 FERC para. 61,075 (Issued January 25, 1985); and Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-047; Petition to Amend, 49 Fed. Reg. 47,327 (December 3, 1984). In extending the program in the January 25, 1985 order, the Commissioners observed that it had "achieved some net benefits" for Northern. See Order Amending Certificate, 30 FERC at p. 61,123. The Commission denied Northern Natural's request for rehearing of the January 25, 1985 order on April 5, 1985. Northern was again objecting to the revenue crediting requirements. See Northern Natural Gas Company, Division of InterNorth, Inc., Docket Nos. CP83-14-070 and CP83-14-074; Order Denying Rehearing, 31 FERC para. 61,020 (Issued April 5, 1985).
discount sale program, it is our conclusion that the Northern's requested certificate extension should be denied.\textsuperscript{180}

The Commission denied Northern Natural's petition for rehearing in December 1985.\textsuperscript{181}

**The Court Orders**

A three judge panel of the U.S. Court of Appeals for the D.C. Circuit issued its opinion in *Northern Natural Gas, Division of InterNorth v. FERC* in late December 1985, two months after the program had expired.\textsuperscript{182} The judges noted and rejected the Commission argument that the Northern revenue crediting provision was different from the requirement, overturned by the court in *Panhandle*, that revenues received by the pipeline for providing transportation services were to be passed through to its gas sales customers. The Commission argued that *Panhandle* involved two sets of customers, transportation customers and gas purchase customers, while the Northern Natural program involved customers of the same class. According to this reasoning, Northern's general rate structure was being reviewed because the reasonableness of the discount sales depended upon the nondiscount rates to the other customers.

\textsuperscript{180} Citation omitted. See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-103; Order Denying Petition to Amend Certificate, 33 FERC para. 61,066 (Issued October 25, 1985) at pp. 61,146-61,147.

\textsuperscript{181} See Northern Natural Gas Company, Division of InterNorth, Inc., Docket No. CP83-14-121; Notice of Denial of Rehearing, 33 FERC para. 61,330 (Issued December 9, 1985).

\textsuperscript{182} Northern Natural Gas Company, Division of InterNorth, Inc. v. Federal Energy Regulatory Commission, 780 F.2d 59 (D.C. Cir. 1985).
The judges stated that accepting the Commission’s distinction would result in more uncertainty and litigation. They noted that the court in *Panhandle* had said that in a section 7 proceeding all of the pipeline’s rates were "before" the Commission, but that they were not inclined to commit themselves to a case by case determination of which rates were "before" the Commission moreso than others. The court said that it was not an answer "to say that only rates to customers of ‘different classes’ will be untouchable in a section 7 proceeding" because the customers who could switch fuels and the captive customers who could not "no more belong to the ‘same’ class than do the gas-purchase customers and gas-transportation customers at issue in *Panhandle*."

Thus, the panel decided that *Panhandle* prohibited the revenue crediting requirement attached by the Commission to the Northern Natural program. The court had ruled that the FERC could not alter in a section 7 proceeding previously approved rates for customers not receiving the services under consideration in the proceeding.

The certification here was for flexible-pricing services; the rates for customers receiving other services could not lawfully be altered. It may be true that the consequence of this holding, in the present case and in many others, will be to compel the Commission to reject innovative certification proposals that benefit some customers while leaving others at least no worse off. But since that is always the effect of *Panhandle*, it is an argument for overruling the case rather than a guide to interpreting it.\(^{184}\)

The panel vacated the revenue crediting requirement, however this decision was set aside three months later, in March 1986, when the full

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\(^{183}\) Ibid., p. 62.

\(^{184}\) Ibid., pp. 62-63. Emphasis in original.
D.C. Court of Appeals decided to reconsider the *Panhandle* decision and whether to continue to adhere to it.\textsuperscript{185}

The Court of Appeals decided the case en banc in August 1987. The judges reaffirmed the *Panhandle* ruling and then applied that decision to the Northern Natural case.\textsuperscript{186} The court discussed three arguments offered by the Commission: first, that Northern Natural, in offering the discount rates, altered previously approved rates itself and the Commission restored stability by imposing the revenue crediting requirement; second, that the rate for the discount service would have been unduly discriminatory compared to rates charged to nondiscount customers if the revenue crediting had not been included; and third, that service to the noneligible, nondiscount customers was properly before the Commission and thus able to be considered in the proceeding.

The court used the *Panhandle* ruling to dispose quickly of the first two arguments, stating that the section 7 conditioning authority could not be used to overturn established rates. Two other sections of the Natural Gas Act had prescribed procedures for the FERC to follow. Those were section 4 covering filing and setting of pipeline rates and section 5 allowing the Commission to determine just and reasonable rates itself. Borrowing the language from the *Panhandle* decision, the court said that using section 7 as the Commission had in the Northern Natural case would "effectively emasculate" those other sections.\textsuperscript{187}

Regarding the Commission's third argument, the court stated that the FERC believed that it had before it any rates that it needed to evaluate in order to resolve a proceeding covering a proposed section 7

\textsuperscript{185} Ibid., p. 64.

\textsuperscript{186} Northern Natural Gas Company, Division of InterNorth, Inc. v. Federal Energy Regulatory Commission, 827 F.2d 779 (D.C. Cir. 1987).

\textsuperscript{187} Ibid., pp. 793-794.
service. However, the judges in relying on *Panhandle* believed that the FERC could condition only the rate for the service actually being certified in the proceeding. They stated "in the section 7 proceeding before us, the Commission used the revenue-crediting condition to adjust the previously approved rate for the already certificated non-discount service. Under the clear dictate of *Panhandle*, this condition must be vacated."

Thus, the full court ruled that *Panhandle* had been "correctly decided" and then reached the same result as the panel had, vacating the revenue crediting requirement. The case was remanded to the Commission for further proceedings.\(^{189}\)

**Commission Response**

The FERC issued its order responding to the court's remand in January 1988. The revenue crediting requirement was vacated "consistent with the Court of Appeals' order." By this time the program had not operated for over two years, since October 1985. Thus, the Commission stated that "under the circumstance, we perceive no merit to a reexamination of the matter to consider whether the certificate would have been approved without [the revenue-crediting requirement] or if a different condition should have been imposed."\(^{190}\)

In short, the Commission implemented the decision in *Northern Natural*, but there was also some evasion. Evasion is seen in the

\(^{188}\) Ibid., pp. 795-796.

\(^{189}\) Ibid., p. 796.

\(^{190}\) See *Northern Natural Gas Company, Division of InterNorth, Inc.*, Docket Nos. CP83-14-123 and CP83-14-124; Order on Remand Vacating Conditions, 42 FERC para. 61,044 (Issued January 21, 1988) at p. 61,271.
language of the implementing order whereby the FERC did not examine the broader issue of whether it should have included the revenue-crediting requirement in its approval of Northern's program. Implementation was a narrow interpretation: case closed (the program after all had already expired) and the FERC moved on. It should also be mentioned that there was some defiance in the usual manner of seeking rehearing. This appears to be a major expression of Commission defiance or subversion of a court order (i.e. attempting to have it overturned on appeal).

The Consolidated Edison Abandonment Case

The Northern Natural case dealt with FERC authority under section 7 of the Natural Gas Act to condition certificates for the provision or the beginning of service in interstate commerce. Section 7 also provided that a natural gas company, defined as a person engaged in the transportation or sale of gas for resale in interstate commerce, must obtain approval from the FERC before ending or abandoning its service or facilities. This requirement applies to both producers and pipelines and was intended to guarantee a safe and steady supply of gas in the interstate market. The Commission had to decide that it was in the public interest that a service be ended just as it had decided that it was in the public interest that the service be commenced.

As described in the section on the Maryland People's Counsel cases, the FERC in the mid-1980s was pursuing initiatives in the area of gas transportation that would allow for less regulation and supervision of pipeline-customer transactions especially when the pipeline subscribed to Order No. 436. The Commission's aim was to foster the development of the natural gas spot market, with a diminished role for government and a greater role for market forces in determining the movement of fuel around the country. The case described in this section, Consolidated
Edison v. FERC, relates to the Commission's attempt to apply this philosophy of greater reliance on the market to the area of abandonment just as it had done with gas transportation.

The Con Ed case also reflects the diverging interests of producers, pipelines, and consumers. Producers wanted to be able to sell more of their gas and move more of their product to the market. Abandonment of service would help them in pursuing their objectives. Pipelines were bound by the provisions in their contracts with producers that forced them to take some higher-priced gas first and thus shut in some producers. Consumers sought continued reliable supplies while being concerned about changes in the market and in FERC policies. The Commission's moves to develop a freer market for gas were thus played out against these diverging interests and naturally resulted in a court challenge.

FERC Policy Decisions

In October 1983 two producers, Felmont Oil Corporation and Essex Offshore, Inc., filed an application with the FERC to abandon sales of gas to Transcontinental Gas Pipe Line Corporation (Transco) from a gas field in Louisiana. The contract between the producers and Transco had expired in September 1981 and the pipeline was taking less gas than the maximum that could be delivered at any one time. The producers wished to sell their gas to another purchaser who would take more than Transco was. They argued that the FERC would be helping the transition to a free market first by recognizing that Transco's contractual rights had expired and then by allowing the producers to sell their gas to a new purchaser willing to offer more favorable terms for the fuel.

Transco responded that it was faced with an excess gas supply and had reduced its purchases from various producers but it was trying to alleviate the situation. The pipeline also stated that it continued to need
reserves of gas dedicated to it for the long term. Loss of the low-cost gas supplied by Felmont and Essex would have an adverse impact on its operations. In May 1985, the Commission ordered a hearing on the application before an administrative law judge.\textsuperscript{191}

The judge issued his opinion in August 1985, noting the producers' argument that abandonment should be granted for them under the public interest test of section 7(b) of the Natural Gas Act. That test mandated that the "present or future public convenience or necessity permit such abandonment."\textsuperscript{192}

After considering the arguments, however, the judge denied the producers' application. It was not possible to compare Transco's needs with those of the other buyer, the principal test for the public interest standard, because Felmont and Essex did not have another prospective buyer for their gas. Potential harm to the producers if the application was denied was another test but Felmont and Essex had stated that they would not be harmed. The judge found that the public interest could be

\textsuperscript{191} See Felmont Oil Corporation and Essex Offshore, Inc., Docket No. CI84-10-000; Order Setting Abandonment Application for Hearing, 31 FERC para. 61,233 (Issued May 21, 1985) at pp. 61,455-61,456.

\textsuperscript{192} See Felmont Oil Corporation and Essex Offshore, Inc., Docket No. CI84-10-000; Initial Decision Denying Abandonment Application, Rejecting Contested Offer of Settlement and Denying Request to Certify Contested Offer of Settlement, 32 FERC para. 63,071 (Issued August 28, 1985) at p. 65,209. The judge observed that the FERC had been instructed by the courts to weigh a variety of factors when considering abandonment under the public interest standard. Those factors included the needs of the two natural gas systems, present and future, that wanted to buy the producers' gas and the requirements of the markets served by those systems. The Commission also had to consider the environmental effects of its decision, the economic effects on the pipelines and their customers, and the presumption in favor of continued service over abandonment. The applicant for abandonment had to prove that it would not harm the public interest. Abandonment could not be granted simply because the producers wanted to divert the gas to a more profitable sale.
disserved if the producers' application was granted. Other producers whose contracts with Transco had also expired might file for abandonment. The pipeline's long-term reserves of gas would decline and its average cost of gas might increase, harming consumers.¹⁹³

Felmont and Essex also proposed, subsequent to their original application for abandonment, an offer of settlement. This agreement would have lasted for three years and would have allowed Transco to specify every six months the amount of gas that it expected to purchase during the following six months. The producers would then sell the remainder of their gas, not taken by Transco, to other parties. Transco wanted some changes to be made in this offer before it would support it. The judge, however, rejected the proposal for essentially the same reasons that he had not accepted the original application for abandonment (no prospective purchaser for the gas, no harm to producers if the offer was rejected, no refutation by the producers of the evidence that Transco would need the gas).¹⁹⁴

In their decision, Opinion No. 245 issued in December 1985, the Commissioners noted that changes in the natural gas market had occurred since the passage of the Natural Gas Policy Act in 1978. The rationale for the prior abandonment policy was thus "far less compelling" and the Commission had to take a broader approach to the issue.¹⁹⁵ They described the situation on many pipeline systems, noting that low-cost gas was not being taken as much as it could be. Pipelines, faced with

¹⁹³ Ibid., pp. 65,210-65,211.

¹⁹⁴ Ibid., pp. 65,211-65,213.

¹⁹⁵ See Felmont Oil Corporation and Essex Offshore, Inc., Docket No. CI84-10-000; Opinion No. 245; Opinion and Order Modifying Initial Decision and Granting Partial, Limited-Term Abandonment, 33 FERC para. 61,333 (Issued December 9, 1985) at pp. 61,655-61,656.
contract requirements such as take-or-pay provisions, were taking more expensive gas to avoid having to pay for that gas without having taken it.

The Commissioners wanted to move more of the low-cost gas into the market. They believed that a pipeline would be more likely to take the cheaper gas if its producers were contemplating abandonment of service to the pipeline because of its failure to take the fuel. Cheaper gas displacing higher cost gas on a pipeline’s system would create incentives for the pipelines and the producers of high-cost gas to renegotiate their contracts to lower prices and lower take requirements. More lower-cost gas entering the market would put pressure on all sellers of gas to reduce their prices.

With this rationale, the Commission decided to revise its abandonment policy.

Thus, where a party can demonstrate that abandonment in a particular instance would have beneficial effects on the market overall, such as increasing competition and causing gas prices to respond to that competition, and the benefits of the abandonment outweigh any adverse effect to the purchaser to whom the gas is presently dedicated, or that purchaser’s customers, the Commission will grant abandonment. ...The real change from the past will be a shift in the identification of the public interest, from the interest of only specific customers to the interests of the market as a whole, and in the determination of how the public’s needs are best served.196

The Commissioners granted Felmont and Essex’s request, believing that abandonment would benefit the market as a whole. They stated that the administrative law judge had used the traditional criteria to determine

196 Ibid., p. 61,657. The Commission added that it was not rejecting the old standard entirely. The traditional factors, such as environmental and economic consequences, parties’ contract arrangements, and parties’ comparative needs, would still be considered.
whether the application of Felmont and Essex would be in the public interest. However, "we believe that the additional concerns about the public convenience and necessity which we have expressed above require a different outcome."197

The FERC issued Opinion No. 245-A, denying rehearing of Opinion No. 245, in February 1986. Among those requesting rehearing was Consolidated Edison Company of New York, an electric utility. Con Ed had also opposed the abandonment before the administrative law judge and before the Commission when it issued Opinion No. 245. Noting that Transco was the only pipeline connected to Felmont's and Essex's wells, the power company argued that that pipeline should have been required to provide transportation service for those parties purchasing the gas that it (Transco) did not take.198 Con Ed (along with the New York Public Service Commission, another party in the subsequent court case) further contended that Felmont and Essex, in return for securing abandonment,

197 Ibid., p. 61,658. In overturning the decision of the judge, the Commissioners acted in a manner that was apparently relatively rare at the FERC. In an interview with a Commission publication, the chief administrative law judge of the FERC observed that "more than 95 percent" of the judges' decisions were affirmed by the Commission. Such a high rate meant that "the judges are simply doing what they are supposed to do. That is, they are applying the policy of the Commission and the law as enacted by Congress or decreed by the courts to the facts of a particular case." Reversal of a judge was the result of "unannounced policy changes by the Commission" as was the case with Opinion No. 245 or "a total absence of Commission policy on the subject matter." See "FERC Chief Judge Wagner: An Interview," FERC Monitor, August 24, 1981, p. 1.

198 Under the terms of the abandonment granted by the FERC, Transco would specify at least thirty days in advance the volumes that it expected to purchase during the following six months. Volumes not taken by Transco could then be sold to other customers.

250
should have been required to reduce their prices in other sales to Transco to the pipeline's average cost of gas.¹⁹⁹

The Commission rejected the requests. Approving the application of Felmont and Essex would not be dependent on the producers reducing their prices in other sales to Transco, because the Commissioners did not want to use abandonment as the primary vehicle for solving all of the gas market's problems. The policy was intended to remove barriers and not to mandate behavior. In addition, there was no evidence available to assess the effect of such a requirement and the Commissioners felt that the conditions imposed in Opinion No. 245 were adequate. The Commissioners declined to order Transco to transport gas that it did not take for its customers who did purchase the fuel. They stated that they did not want to order anything other than abandonment and questioned whether they had the authority to mandate any such transportation.²⁰⁰

The New York Public Service Commission argued that the FERC had not applied properly the criteria for evaluating abandonment applications. Comparing the interests of the pipeline's customers with the Commission's view of how inexpensive gas ought to be sold was not a standard from the Natural Gas Act. The PSC also argued that the FERC had insufficient evidence to support its claims of positive effects from the abandonment.²⁰¹

¹⁹⁹ See Felmont Oil Corporation and Essex Offshore, Inc., Docket Nos. CI84-10-001 through 004; Opinion No. 245-A; Opinion and Order Denying Rehearing, 34 FERC para. 61,296 (Issued February 28, 1986) at p. 61,532.

²⁰⁰ Ibid., pp. 61,534-61,535.

The FERC rejected the New York PSC arguments. The Commissioners stated that the New York Commission was arguing that the NGA-based criteria could not change as conditions changed and that the FERC could not depart from those standards. Because of the "fundamental changes" that had occurred in gas markets and in regulation since the passage of the NGPA, the FERC had to take a "broader approach" to abandonment. Opinion No. 245 was thus "a careful and modest application of the Commission's revised approach to abandonment." The FERC also did not agree that there was insufficient evidence to support approval of the abandonment. The Commission had "carefully" explained its findings and the support for them in Opinion No. 245. The "changing nature of the natural gas market" had necessitated a new approach, but traditional factors had still been considered as well.\(^2\)

Consolidated Edison and the New York PSC both argued that the Commission’s expectations of contract renegotiation were unsupported. Abandonment of a low-cost sale did not provide any incentive for producers to renegotiate higher priced contracts. On the contrary, releasing low cost gas for sale to others, by providing more cash flow to the producers, would reduce any incentive for renegotiation. The FERC Commissioners disagreed, arguing as they had in Opinion No. 245 that abandonment of low-cost supplies would allow that gas to be sold elsewhere. This would displace high-cost gas and create incentives for producers to decrease prices. The Commissioners added that they expected "reductions in take-or-pay levels to become a *quid pro quo* for a producer to obtain its pipeline’s concurrence and cooperation in sought-after abandonments."\(^3\)

\(^{2}\) See Opinion No. 245-A, 34 FERC at pp. 61,532-61,533.

\(^{3}\) Ibid., pp. 61,531 and 61,534. See also "Rehearing Requests Challenge Many Aspects," pp. 9-10.
Consolidated Edison v. FERC

Having been denied in their attempts to have the FERC reconsider its opinion on abandonment, various parties including Transco, Con Ed, and the New York PSC pursued a case against the Commission in the U.S. Court of Appeals for the District of Columbia. The court decided *Consolidated Edison Company of New York, Inc. v. Federal Energy Regulatory Commission* in July 1987.\(^{204}\)

The court agreed with the FERC that the Natural Gas Act did not require the comparative needs test (comparing the needs of the current consumers of the gas with the needs of the proposed consumers). The issue for the judges to decide was not whether the FERC could change the abandonment policy but whether its reasons for doing so were permissible.

The court then considered those reasons. Four justifications from Opinion No. 245, benefits to be realized from releasing shut-in gas (gas not being taken by pipelines) to the market, were analyzed. First, other purchasers could lower their gas costs by using the cheaper shut-in gas that would now be available instead of more expensive alternative gas or other fuels. The court found this reason valid in theory. However, the judges stated that the FERC had not explained how the captive customers, bound to pipelines that were themselves bound by take-or-pay contracts that made it uneconomical to switch to new markets for gas, would benefit from the new abandonment policy. More mobile fuel-switchable customers could possibly take advantage of the cheaper gas.

The Commission's second justification was that if the cheaper gas created more competition in the marketplace, pressure would be exerted

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on all sellers of gas to lower their prices or risk being shut in. The court considered this reason to be a corollary of the first and it noted that only customers actually able to switch from one supplier of gas to another would be able to apply the pressure.

The third FERC justification was that if gas dedicated to a particular pipeline was likely to be subject to a request for abandonment by the producers of the gas, the pipeline would be more likely to take it instead of risk losing it. Assuming this was lower priced gas, the pipeline's overall cost of gas would be lowered. The judges had "serious doubts" about the validity of this justification. The court felt that the Commission's assumption that the pipeline would take more of the cheaper gas to avoid losing it made sense only if demand for gas increased. If demand did not increase, then pipeline would be taking the low-cost gas to avoid losing it instead of high-cost gas that the carrier was bound to take by a take-or-pay contract. The pipeline would be incurring liability for the high-cost gas, which it would have to pay even if it did not take the fuel, thus raising and not lowering its cost of gas. According to the court, "... this apparent Commission confusion regarding the effect of its new policy on the take-or-pay problem is a fundamental and pervasive flaw that infects the major part of its reasoning on abandonment."^{205}

The court found "highly problematic" the Commission's assumption that its abandonment policy would lessen the problems of take-or-pay contracts forcing pipelines to take high-cost gas or pay for that gas anyway. The fourth FERC justification for the abandonment policy "lies at the center of our apprehension in this regard."^{206}

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^{205} Ibid., p. 638.

^{206} Ibid.
The fourth reason for the Commission's adoption of the new policy was that if cheaper gas displaced more expensive gas on a pipeline's system, there would be incentives for the pipeline and the producers of high-cost gas to renegotiate their contracts to reduce take-or-pay requirements and lower the price of gas. As a result of such renegotiation, the pipeline would be able to continue to buy the producers' gas. The court found the logic of this justification "difficult to understand."

It seems counterintuitive to argue that pipelines will stop taking gas that they have to pay for anyway and that as a result producers will have an incentive to renegotiate contracts in which they are guaranteed high payments whether or not the customers take the gas. On the contrary: The whole purpose of take-or-pay contracts is to give the producers the same benefit whether or not the gas in question actually leaves the ground.

The judges sympathized with the Commission, but the problems of the contracts "will not be wished away."207

Recalling the reasoning of the panel in the *Associated Gas Distributors* remand of Order No. 436, the judges felt that the Commission was confusing the pipelines' incentives to renegotiate take-or-pay contracts with their ability to do so. The incentives were great but the ability was "increasingly slim."208 Producers could benefit from selling previously shut-in gas under the new policy. However, there would be less incentive for them to renegotiate the take-or-pay contracts with the pipelines, worsening the pipelines' problems of having to take or pay for high-cost gas.

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207 Ibid., pp. 639-640. Emphasis in the original, citation omitted.

208 Ibid., p. 641.
The panel decided to remand the opinion because of the take-or-pay problem, "although given proper bases we might well uphold it." The Commission would be free to reissue the same order if it could provide an adequate explanation of how to deal with take-or-pay. Opinion No. 245 and the Commission's justifications reflected a "pervasive frame of mind of the Commission" also seen in Order No. 436 (which had just been reviewed by the D.C. Court in the AGD case). That was "a refusal to face the fact that the burdensome take-or-pay contracts will not go away through deregulatory actions that, while aiding much of the industry, actually appear to place more pressure on the pipelines." In remanding the order, the court hoped that the FERC would take a "harder look" at the benefits of the abandonment policy.209

Commission Response

The FERC response to the court's decision in Con Ed came in an order issued in February 1988. The Commission stated its conclusion that the new abandonment policy of Opinion No. 245 was "a proper and beneficial adjustment" to its regulations due to the current gas market conditions and the changes caused by the Natural Gas Policy Act.210

The Commissioners discussed the possible adverse effects of the abandonment policy on pipeline take-or-pay problems. They noted, however, that because of other actions taken by the FERC (Order No. 500 issued in response to the AGD ruling) those bad effects were not likely to outweigh the benefits of the policy. As discussed above the

209 Ibid., pp. 641-642. Emphasis in the original.

210 See Felmont Oil Corporation and Essex Offshore, Inc., Docket No. CI84-10-006; Order on Remand Reaffirming Prior Determination, 42 FERC para. 61,172 (Issued February 5, 1988) at p. 61,613.
Commission in Order No. 500 required a producer to credit gas transported by an open access pipeline against the pipeline's take-or-pay liability to the producer. That crediting mechanism would mitigate the accumulation of more take-or-pay liability by a pipeline and permitted the FERC to modify its abandonment policy "so as to obtain the benefit ... of lower overall prices to consumers even though there may be some adverse effect as a result on pipelines' take-or-pay problems." The Commission accordingly reaffirmed Opinion No. 245.

Other Commission Policy Actions

The FERC was pursuing its new abandonment policy initiative in other more far-reaching ways besides Opinion No. 245. The Commission issued a Notice of Proposed Rulemaking (NOPR) in May 1987 approximately two and one-half months before the Consolidated Edison case was decided. The rulemaking dealt with abandonment of sales and purchases of gas under expired, terminated, or modified contracts and is relevant to this discussion because the final rule that resulted was a response to the Consolidated Edison decision.

The proposed rule was to apply to "first sales" of gas as defined in the NGPA and to purchases by a pipeline from a producer or from another pipeline. The proposal was that any party to a contract for those

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211 Ibid., p. 61,616.

212 See Abandonment of Sales and Purchases of Natural Gas under Expired, Terminated, or Modified Contracts; Notice of Proposed Rulemaking; Docket No RM87-16-000; Issued May 7, 1987, 52 Fed. Reg. 18,703 (May 19, 1987). In the case leading up to Opinion No. 245, the original contract between the producers Felmont and Essex and the pipeline Transco had expired. Service to Transco was being provided under an interim agreement that was renewed on a daily basis, subject to written cancellation.
sales could, after giving thirty days' advance notice, stop its sales or purchases under the contract if the agreement had previously expired or if the party terminated it by using an option included in the contract that allowed such action. The parties could also agree to terminate the contract. If a pipeline abandoned purchases from a producer, it would have to provide transportation for the abandoned gas to the new purchasers. Abandonment would be granted automatically if the requirements of the rule were satisfied and the policy would be applied to all contracts between producers and pipelines.\textsuperscript{213}

The final rule on abandonment, Order No. 490, was issued in February 1988 at the same time as the FERC order responding to the \textit{Consolidated Edison} decision. The Commissioners made two revisions in the proposed rule. One was to include first sales to local distributors (which had been specifically excluded in the NOPR) in the new framework. The other was to mandate that only pipelines accepting certificates of public convenience and necessity under Order No. 500 (thus being open access carriers) could participate in the new policy.\textsuperscript{214}

The order also included a discussion of the \textit{Consolidated Edison} ruling, as well as the \textit{Associated Gas Distributors v. FERC} decision on Order No. 436. The Commissioners stated that "nothing in those decisions" had required any changes in the new abandonment policy being

\textsuperscript{213} Ibid., pp. 18,708-18,709. A first sale of gas was a sale to any interstate or intrastate pipeline, a distributor, or any person for use by that person which preceded any other sale. The Commission was also empowered by the NGPA to designate sales as first sales to prevent circumvention of the law's prescribed maximum prices. See NGPA, section 2 at 15 U.S.C. sec. 3301(21)(A)(1988).

\textsuperscript{214} See Abandonment of Sales and Purchases of Natural Gas under Expired, Terminated, or Modified Contracts; Final Rule; Docket No. RM87-16-000; Order No. 490; Issued February 5, 1988, 53 Fed. Reg. 4,121 (February 12, 1988) at pp. 4,122-4,123.

258
promulgated in Order No. 490. Instead those rulings provided support for the new rule. According to the FERC, the court supported the Commission's authority to establish a new abandonment policy, provided that it was explained well and reasonably decided.

The Commissioners said that the order could help pipelines by enabling them to terminate their obligations to purchase gas under expired high-price contracts. The rule would "assist them [pipelines], and in no event place them in a worse position because it is in their discretion to so act. ...the rule merely authorizes the pipeline to abandon purchases but does not mandate it."

The Commissioners noted that allowing abandonment under Order No. 490 would occasionally worsen the take-or-pay problem of a pipeline that was an Order No. 500 open access carrier. However, "this will be a gradual process because it applies to contracts as they expire." In addition, the FERC had considered take-or-pay "comprehensively" in Order No. 500 and decided that terminated contracts would not qualify for crediting under that rule. Thus, the Commissioners concluded that "the overall benefit of the rule [Order No. 490], combined with the comprehensive treatment of the take-or-pay problem in Order No. 500, adequately addresses the limited impact that this rule may have on the pipelines' take-or-pay exposure" and was in accord with the court rulings in *Consolidated Edison* and *Associated Gas Distributors.*

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215 Ibid., p. 4,126.

216 Ibid., p. 4,127.

217 Ibid., p. 4,128. Whether the rule addressed adequately the take-or-pay concerns of the court is as usual open to debate. Two members of the FERC, Commissioners Stalon and Sousa, expressed concerns. Sousa concurred in part and dissented in part, supporting the overall policy objective of "lessening regulation so long as it is in the public interest,"
The Commission’s response to the *Con Ed* decision would appear to tend toward implementation rather than evasion. As in the *AGD* case, the court told the FERC to take action on the take-or-pay problem. One could debate the effectiveness of the remedy chosen by the Commission but the court in *Con Ed* stated its willingness to uphold Opinion No. 245. The Commission did respond to the court’s concerns (it had to do something in order to save its two major policies: transportation as well as abandonment) and importantly in Order No. 490 the FERC required participation in the Order No. 500 open access program in order for a pipeline to participate also in the abandonment program.

**Conclusion**

The observations made in this chapter on the Commission’s response, implementation or evasion, to the court mandates in these five cases are summarized below.

*Mid-Louisiana:* Implementation and evasion concurrently followed by implementation after second court ruling

\[\text{(...continued)}\]

but dissenting to the lack of take-or-pay relief when the producer initiated abandonment and to the requirement that the pipeline have an Order No. 500 blanket certificate in order to abandon service. Sousa said that the inclusion of these two provisions was "grossly unfair." He would have supported the blanket certificate requirement if producers initiating abandonment were required to grant take-or-pay relief. The effect of the rule would be "that it will inevitably exacerbate the take-or-pay problem."

In his concurring opinion, Stalon agreed with Sousa’s concern over no take-or-pay relief in the case of producer initiated abandonment. He said that the Commission should have required the producer to refund prepayments or allowed the purchaser to make up the gas for which it had made the prepayments. See p. 4,134.
INGAA: Implementation and evasion concurrently followed by implementation after second court ruling

MPC/AGD: Implementation limited somewhat by evasion/caution (MPC); implementation after AGD

Northern Natural: Implementation in form of narrow interpretation; evasion/avoidance of full consequences of ruling

Con Ed: Implementation (in light of signal from court)

As can be seen, the Commission does obey the court for the most part. All of the cases are characterized by implementation. There is a fair amount of evasion as well, however. The Commission did try to overturn some rulings on appeal (Mid-La, INGAA, and Northern Natural), did interpret one ruling narrowly (Northern Natural), and was cautious in applying judicial mandates with major potential disruptive effects and thus sought to evade their full impact (INGAA and MPC).

As noted in Chapter 1, agency response to the court is viewed in this research as a single dimension although the agency could be at different points of the continuum (i.e. pursuing seemingly contradictory courses of action) at the same time. When implementation was easier, the Commission proceeded with less evasion. Such was the case in Northern Natural and Con Ed. In the other cases, implementation was more difficult involving the overthrow of a long-established policy (Mid-La), large sums of revenues (INGAA and MPC), or widespread industry practices (MPC/AGD). In these latter cases a second court ruling was important, nudging the FERC to the implementation end of the continuum.

Table 3.1 below contains an overview of the main features of the five cases. The discussion in this chapter shows the variety, both implementation and evasion, in the Commission's response to the court rulings. The analysis in the next chapter attempts to explain the agency’s actions in terms of the five independent variables described in Chapter 1.
FERC Policy Decision: Order No. 58 denying NGPA first sale pricing to intracorporate transactions; Order No. 98 applying NGPA pricing to gas produced by a pipeline or its affiliate only from newer wells or more recently leased property (or gas that had received special area or national rates before the NGPA)—older wells and leases would continue to receive lower cost of service prices.

Active Interests: Pipelines argued that the FERC could have imputed a sale at the wellhead and that the Commission had improperly asserted authority in Order No. 98 over pipeline production.

Court Decision: Fifth Circuit vacated Order No. 58 saying that Congress intended gas volumes attributable to a pipeline or affiliate to receive first sale treatment and that the intracorporate transfer was that first sale; Order No. 98 was also vacated because the court held that the FERC lacked authority under the Natural Gas Act to set prices for interstate pipeline production. Supreme Court agreed that pipeline production should receive NGPA pricing but remanded case back to FERC to decide whether first sale occurred at intracorporate production to transmission phase or at sale from pipeline to customer.

FERC Response: Intracorporate transfer of gas from a pipeline’s production division to its transmission division and sales by affiliates designated as first sales. Other actions constituting both implementation and evasion. For example, after the Fifth Circuit ruling the Commissioners decided to allow pipelines to file to pass through to their customers the increased gas costs resulting from the higher NGPA pricing of their own production. However, they also decided by a majority vote to appeal the case to the Supreme Court and they made other decisions limiting the ability of some pipelines to take advantage of the *Mid-Louisiana* ruling.

**INGAA**

A. **INGAA I**

FERC Policy Decision: For NGPA pricing purposes, shifting the standard for measuring the energy (Btu) content of gas from "wet" rule ("saturated with water vapor" in standard lab conditions) to "dry" or "as delivered" rule (actual Btu content of gas upon delivery).

To be continued
Table 3.1 (continued)

**Active Interests:** Producers argued that "dry" rule was needed as "wet" rule understated energy content and thus undercompensated them for product. Pipelines and distributors said that NGPA did not allow "dry" rule. Congress had not criticized "wet" rule in NGPA proceedings.

**Court Decision:** "Dry" rule vacated as inconsistent with NGPA; detailed pricing structure of that statute undermined FERC argument as "wet" rule would have been only standard with which Congress would have been familiar.

**FERC Response:** "Wet" rule reinstated; producers ordered to pay refunds of excess revenues collected under "dry" rule.

**B. INGAA II**

**FERC Policy Decision:** Allowing offset of Btu refunds owed by producers to pipelines with NGPA section 110 production-related costs owed by pipelines to producers.

**Active Interests:** Producers and pipelines supported offset to simplify complicated refund process; distributors and consumers argued that offset would be at their expense and said that FERC must comply with INGAA I.

**Court Decision:** Offset vacated; FERC had not provided adequate explanation for reversing itself and using offset; offset would delay payment of funds to those customers who were overcharged under the "dry" rule.

**FERC Response:** Offset vacated and producers ordered to pay Btu refunds.

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**Maryland People's Counsel**

**A. Maryland People's Counsel**

**FERC Policy Decision:** Commission orders that established blanket certificate transportation and special marketing programs allowing pipelines to carry gas on behalf of various customers (commercial, industrial, agricultural, schools, and hospitals) without FERC approval for each transaction or to carry gas released from a producer-pipeline contract and then sold directly by the producer to a customer other than a pipeline (usually industrial). Captive residential customers were excluded from the programs.

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To be continued
Active Interests: Consumer groups claimed that the programs were discriminatory and harmful to residential and commercial customers; pipelines and producers had developed many of the special marketing programs while pipelines and industrial customers were actively using the blanket certificates.

Court Decision: Blanket certificate and special marketing programs were overturned as anticompetitive and discriminatory because of the exclusion of the captive customers.

FERC Response: Development of new transportation policy already in progress was hastened.

B. Associated Gas Distributors

FERC Policy Decision: Transportation program (Order No. 436) including open access, first-come, first-served allocation of capacity, contract demand modification.

Active Interests: Pipelines and producers supported nondiscriminatory access; pipelines concerned that use of contract demand provisions would aggravate take-or-pay problems; Maryland People’s Counsel argued against continued use by pipelines of section 7 certificates to avoid provisions of 436; distributors felt that FERC had to address take-or-pay problem.

Court Decision: Court vacated and remanded Order No. 436 mainly because of inadequate explanation for not acting on producer-pipeline contracts but also finding inadequate rationale for contract demand reduction.

FERC Response: Order No. 500 including a system of transportation credits whereby a pipeline could refuse to carry a producer’s gas unless the producer offered to credit the transported fuel against the pipeline’s take-or-pay liability to the producer. Contract demand reduction dropped but conversion retained.

Northern Natural

FERC Policy Decision: In approving a NGA section 7(c) certificate for new rates that Northern wanted to offer customers that could switch fuels, FERC imposed the requirement that customers of Northern who were not eligible to take part in the program should receive some revenues that the carrier earned from the sales.

To be continued
Active Interests: Iowa State Commerce Commission, Process Gas Consumers and industrial groups argued that Northern program was discriminatory.

Court Decision: Court, reaffirming one of its previous decisions, said that the Commission's stipulation was a modification of previously approved rates. The Commission would have to use a section 5 (NGA) proceeding to change such rates and not a section 7 certification procedure.

FERC Response: FERC issued an order vacating the revenue crediting requirement but not considering the larger issue of whether a different condition should have been imposed.

Consolidated Edison

FERC Policy Decision: Approved new criteria for abandonment of service from producer to pipeline; allowing abandonments that would have benefits for market overall and feeling that threat of abandonment and loss of low-cost gas would spur pipelines to take that cheaper fuel instead of the expensive gas that was also under contract.

Active Interests: Con Ed and New York Public Service Commission argued that hopes of contract renegotiation based on abandonment threat were unsupported; abandonment of low-cost contract did not provide producer incentive to reconsider high-cost contract.

Court Decision: Remanded opinion; FERC confused pipelines' incentives to negotiate with "increasingly slim" ability to do so; FERC must provide an explanation of how to deal with take-or-pay.

FERC Response: Responded in an order that the new abandonment policy was "a proper and beneficial adjustment" to regulations and that because of other actions taken (Order No. 500) any bad effects of the policy on pipeline take-or-pay problems were not likely to outweigh the benefits.
CHAPTER 4

THE ROLES OF INTERNAL AND EXTERNAL FACTORS IN THE FIVE CASES

With the chronology of the five cases and descriptions of the various FERC responses to the court orders set forth in the previous chapter, the task here is to examine the role of internal and external factors in shaping those Commission responses in each case. To do this, the guiding questions of the study and the independent and dependent variables, all described in Chapter 1, must first be recalled. After briefly describing the variables and their relationship to each other, the analysis then turns to the interaction of the variables in each of the five cases. The cases are covered in separate sections below with a subsequent section containing a cross-case analysis.

Chapter 1 of this study begins with two questions that need to be mentioned here because of their importance in framing the variables used in the analysis. The first asks how and why does an administrative agency, directed by a court to discontinue a policy or to do things differently, actually respond to this disturbance? The second question asks what role, if any, do such influential outsiders as members of Congress, representatives of interest groups, and other officials from the executive branch have in shaping the agency's response to the court order? Both of these queries are considered in this chapter.
The five independent variables and the dependent variable follow directly from the questions described above. The dependent variable to be explained is agency response to the court order: did the agency implement or evade the order? The actual responses and their characterization as implementation or evasion or both are discussed above in Chapter 3. The independent variables are agency commitment to the program that was the target of the court order, disruptiveness of the court order (i.e., how much the order actually affects the program), the likelihood and severity of penalties for noncompliance with the court order, agency perception of the court as friend or foe, and external pressures on the agency from such outsiders as interest groups, members of Congress or their staffs, and other parts of the executive branch such as the White House.

The hypotheses guiding this research are:

Higher commitment should lead to less faithful implementation of the court order. Lower commitment should lead to more faithful implementation.

Greater disruptiveness should lead to more evasion of or attempts to limit the court order. Lesser disruptiveness should lead to more faithful implementation.

Greater likelihood and severity of penalties for non-compliance (i.e. more litigation) should lead to more faithful implementation. Less likelihood and severity of penalties for noncompliance should lead to less faithful implementation.

A positive agency view of the court should lead to more faithful implementation of the court’s order. A negative agency view of the court should lead to less faithful implementation of the court’s order.

Greater external pressure in support of the court order should lead to more faithful implementation of that order. Greater external pressure in opposition to the
court order should lead to less faithful implementa-
tion of the order.

In addition to the major hypotheses stated above, four other hypotheses concerned with the effects that the independent variables might have on each other above and beyond the impact that they have on the dependent variable are stated in Chapter 1. As noted in that previous chapter, these are treated as lesser hypotheses and are discussed below as the data permit. They are first, that external pressure can affect agency commitment to program at different stages of the rulemaking process; second, that agency commitment to the program will override disruptiveness of the order and likelihood and severity of penalties as a force in agency response to the court; third, that agency views of the court issuing the disruptive order are expected to play some role, but generally not as important a role as commitment to the program; and fourth, that greater agency commitment should result in less of a role for the external pressures in determining agency response to the court.

The consideration of the cases in the following sections shows a different mix of influence among the various independent variables in the different cases. In some instances, such as Northern Natural and Consolidated Edison, agency commitment to the existing program plays the most crucial role. In other instances, such as the INGAA wet/dry rule case and Maryland People's Counsel, commitment was still important but it was overshadowed or tempered occasionally by other factors, such as external pressure or disruption. The cases are considered chronologically below. As noted in Chapter 1, the approach taken within each case analysis is an assessment of the relative importance of each independent variable in terms of its impact on the dependent variable. Assessment of the positive and negative effects of the independent variables constitutes the cross-case analysis at the end of the chapter.

268
As noted in Chapter 3, the Commission response to the court in *Mid-Louisiana* consisted of concurrent implementation and evasion with implementation proceeding after the Supreme Court ruled. As described more fully below, the FERC actions in this case were characterized by high commitment to the program apparently leading to the defiance and evasion up to the time of the Supreme Court ruling; favorable agency view of the court in the sense that the court was viewed as a legitimate authority; some external pressure although not as much as in other cases; apparently low disruptiveness that was probably felt more by the customers who had to pay the higher prices; and low perceived penalties for noncompliance because the agency felt that it was obeying the court as indicated in the *Phillips* case. Each of these independent variables is considered next.

**Agency commitment to the policy** is an important explanatory factor, helping to account for many Commission actions during *Mid-Louisiana*. Commitment is a multifaceted variable here in the sense that there were various reasons or motivations for the Commission's dedication to its policy. One such motivation was that the policy was achieving agency goals and appeared to be in line with congressional intent.

A former senior official of the Office of Pipeline and Producer Regulation (OPPR) remarked that when the NGPA was passed, the question arose of how pipeline produced gas was to be treated in light of

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1 An assistant to Commissioner Stalon stated that this case, along with the *INGAA* decision, represented the FERC "cleaning up past regulatory mistakes" from wrong statutory interpretations identified by the courts.
the law's specification of "first sales." The Commission retained the distinction that it was using between producer gas and pipeline gas and some pipelines found that they had to continue to use cost of service pricing rather than the first sale pricing of the NGPA in order to provide sufficient gas for their systems. The pipelines did not believe that Congress intended to treat all production on a maximum lawful price basis. In light of the court ruling, all pipeline production had then been treated the same as producer gas.¹

The former official stressed that the Commission's goal had been to encourage pipeline gas production dedicated to the interstate market. The court's interpretation was "strictly a legal interpretation" of whether the Commission had correctly interpreted the intent of Congress. The Commission's treatment of pipeline produced gas had the same aim as its treatment of producers: to increase exploration for and production of gas.²

² Unless another source, published or nonpublished, is cited, comments attributed to various individuals are taken from interviews conducted by the author for this research.

³ The former official noted that in the 1970s the FPC had tried to encourage gas production by treating pipeline produced gas the same as independently produced gas. The Commission was trying to set incentive prices for producers and hoped that treating pipeline production in a similar manner would spur production and end shortages in the interstate market. This manner was preferred over cost of service treatment for pipeline production.

⁴ The debate on the question of how to treat pipeline produced gas in light of the passage of the NGPA in 1978 was conducted both inside and outside the FERC. Another official of the OPPR stated that staff was divided initially over the original interpretation of the NGPA and "first sale," reflecting the different sides of the controversy. (Perhaps reflecting the losing side, the staff member noted that "you sometimes have to implement something you don't think is quite right if you can't find enough in the law to support what you think is right. Then you sort of..."
Interestingly, there is some indication that the FERC staff supported the exclusion of older pipeline production from the higher prices provided by the Natural Gas Policy Act more enthusiastically than did the Commissioners (at least initially). One report stated that three of the Commissioners "spent several hours on close and skeptical questioning of the staff members who suggested the idea." At the same time, however, the Commissioners directed the staff to accept pipeline gas cost recovery filings incorporating the policy.

"(...continued) have to do what you wouldn't prefer but what seems to be within the law.") Several memos were written and much research was done on the legislative history of the NGPA to determine any congressional intent over pipeline production. The "final call" was the Commission's but the staff member said that the commissioners would have received memos laying out both sides of the argument.

The official recalled that as the Commission developed these early regulations implementing the NGPA, staff would complete the initial drafts of the rules. For major policies, the office directors would become involved in the process by determining the directions of those programs and sending the rules back to staff to revise according to the decisions made by the directors. Several staff papers contained discussions of the pros and cons of the pipeline production policy options, legal issues, and legislative history but the staff member did not recall there being any formal staff recommendation.

Another staff member from OPPR observed that in a case such as Mid-Louisiana where the interpretation of a statute is at issue, staff can differ over what the law did or did not intend. He stated that "collectively we're probably no better than the people that are fighting opposing views in the court case."


An OPPR staff member felt that despite the divisions at the FERC the Commission, especially the commissioners themselves, was committed to the policy. The FERC Chair at the time the rule was issued, Charles Curtis, had been a congressional staff member and this previous employment might have aided the Commission's impression that it was doing
Another part of commitment in this case was the Commission's view of its duty. Here that meant insuring that pipelines did not earn excessive profits. As noted in Chapter 3, the Commissioners stated that the pipelines had enjoyed the benefits of guaranteed recovery of the costs of production from the cost of service treatment. Their customers were thus entitled to the lower prices afforded by cost of service treatment. In addition, when arguing the case before the Supreme Court, the Commission claimed that the pipelines would receive windfall profits if allowed to collect NGPA prices for the gas that they produced.\(^7\)

\[\ldots\text{continued}\]

what Congress wanted.

A staff member also said that generally disagreements between staff and the commissioners would have surfaced at Commission meetings. Staff memoes and draft rules would be considered at Commission meetings and there would not have been feedback from the commissioners before the public meetings. Disagreements would be resolved at the meetings and staff might agree to make changes in the draft orders. Outsiders could use some of the comments made at the public meeting in petitions for rehearing. On more serious divisions among commissioners (such as two versus three), the matter might be delayed until the commissioners can resolve their differences. The resolution might then be communicated to staff and changes made in the draft rule.

\(^7\) Cost of service prices were as low as 26 cents per million Btu in December 1982 when the case was being argued. The NGPA category which would probably include many of the pipeline wells was then priced at $3.51 per million Btu. See "FERC and Other Parties Reiterated Their Opposition to a 'Windfall' . . . .," *Inside F.E.R.C.*, December 6, 1982, p. 9. See also "Again Rebutting Claims of a 'Windfall' for Pipelines' Own Gas Production. . . .," *Inside F.E.R.C.*, January 24, 1983, pp. 11-12. The pipelines, of course, disputed the windfall claim. One pipeline, Consolidated Gas Supply, claimed that the effect of allowing pipelines to charge the higher NGPA prices for the gas that they produced would amount for 1979 to 1981, if the court's decision were retroactively applied, to 1.44 percent of the total economic impact of the NGPA during that period. Consolidated claimed that the total effect of the law during those years was about $24 billion while the effect of the *Mid-Louisiana* decision (continued...)
As with goal achievement, the Commission felt that this reasoning was in accord with congressional intent. A staff member of the OPPR noted that while there was no doubt that Congress sought to provide incentive pricing for producers, there was some question about whether such pricing should be allowed for pipeline production. The Commission felt that new pipeline production would receive NGPA prices but the questions concerned old, pre-NGPA wells that had received cost of service prices. The two main factors behind the Commission’s decision were: first, that the consumers had borne the risks of the production from the old cost of service priced wells; second, that there was insufficient evidence that Congress wanted the old pipeline production to receive the higher NGPA prices.

*Agency view of the court* is a very important factor in the *Mid-La* sequence of events. The evidence shows a clash of conflicting views: on the one hand, the FERC had embraced a policy intended to spur gas production, protect ratepayers, and carry out what it believed to be congressional intent. The courts, however, took the opposite view. While the Commission resisted and evaded for a while, the Supreme Court provided a final answer. As shown in Chapter 3, changes in presidential administration and FERC membership allowed the Commission ultimately to agree with the courts.

Comments by a former senior official of the Office of Pipeline and Producer Regulation show the Commission’s reaction to the court orders. He felt that the courts had acted wrongly in the *Mid-Louisiana* case.

7(...continued)

would be $347 million. Another pipeline claimed that less than 1 percent of all of the gas affected by the NGPA would be affected by the *Mid-Louisiana* decision. See also "Commission Rises to Defense of Cogeneration, Pipeline-Production Rules," *Inside F.E.R.C.*, March 28, 1983, p. 9.
Customers had covered the costs and the risks of gas production for those pipelines that had been subject to cost of service pricing. To allow such gas to receive the higher NGPA prices did not appear to be "equitable" to the Commission. Such production was older and less expensive than the newer production. The court's decision resulted in "not doing ... equity" for the consumers as producers had never had their costs guaranteed by the consumers. In developing a response to the court order, the official noted that the FERC did not have many options in responding. He observed that "once the Supreme Court says this is what you do, you do [it]."

When the courts decided that NGPA prices applied to pipeline production, an OPPR staff member stated that "the major decision was made" as to what the Commission had to do. Staff knew that the regulations had to be revised to be in accord with the Supreme Court opinion and "there was no other way to go." Everyone at the Commission "knew what it [the Supreme Court ruling] meant; knew we had been wrong" and that the old regulations "had to go."

The impact of external pressure in *Mid-Louisiana* can be briefly described. This case represents a rather typical, prescribed pattern for outsider influence consisting of rulemaking input and litigation in court. The Commission issued a notice of proposed rulemaking for the original policy, inviting comments and input from interested parties. Comments were received and the Commission, in issuing the final rule, responded to these arguments (or at least to some of them) and occasionally provided clarification of various provisions of the rule. Petitions for rehearing of the rule from aggrieved parties were filed but the Commission denied rehearing. Parties then sought judicial review and a new rulemaking commenced in response to the court's decision.

The Commission invited and received input during the course of the rulemaking process but also received unwelcome input in the form of
an adverse judicial ruling. The rulemaking procedure is the official manner by which outside parties can have impact on FERC policymaking. Judicial review, however, is often an additional but important part of that process.

It is important to note that the FERC often goes to great length in discussing and responding to the comments received from the various interests. This was certainly the case in *Mid-Louisiana*. The comments serve as a gauge of industry reaction to the new policy. It is also true, however, that the Commission made no major changes in the proposed policies in *Mid-Louisiana* as a result of the comments. As seen in the discussions of the Btu measurement (implementation of the offset mechanism) and *Maryland People's Counsel* (take-or-pay and block billing

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8 Ideas for new rules may originate with outsiders but most are the suggestions of Commission staff or the Commission. The actual rulemaking proceeding can only be initiated by the Commission. See "The Makings of Rulemakings," *FERC Monitor*, December 29, 1983, pp. 1-2.

9 See the notice of proposed rulemaking (NOPR) and the final rule issued after the Supreme Court's decision. The NOPR is First Sales of Pipeline Production under the Natural Gas Policy Act of 1978; Docket Nos. RM83-72-000 and RM82-16-000; Issued December 28, 1983, 49 Fed. Reg. 70 (January 3, 1984). The final rule is Production under Section 2(21) of the Natural Gas Policy Act of 1978; Docket Nos. RM83-72-000 and RM82-16-000; Order No. 391; Issued August 22, 1984, 49 Fed. Reg. 33,849 (August 27, 1984). In the NOPR, the Commission also asked for comments on the extent of its authority over the rates that an intrastate pipeline could charge for the gas that it produced and resold. This is an example of another function of the rulemaking procedure through which the FERC solicits responses to particular questions and/or recommendations for action on issues on which it may not have yet formulated a policy. As seen in the *Maryland People's Counsel/Associated Gas Distributors* discussion, the Commission sought a fair amount of input through notices of inquiry and rulemaking on the issues surrounding gas transportation as its policy evolved from restricted access under special marketing programs and blanket certificates to more open access to pipelines under Order No. 436.
provisions dropped) cases, the Commission does occasionally take some suggestions from outsider comments.

In the *Mid-Louisiana* case, litigation was the only way for certain parties to accomplish the changes they sought in the policy that FERC had developed particularly since the Commission had foreclosed the alternatives of rulemaking and rehearing. After the Supreme Court’s decision, litigation continued to be the major way for at least one outside party to try to shape the policies that the Commission pursued in this area. The *Phillips* case is an example of this follow-up litigation. In the context of a potentially adversarial regulatory relationship, this is not at all unusual.\(^\text{10}\)

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\(^{10}\) The *Mid-Louisiana* case did attract some additional outside attention from an important actor in the natural gas policy subsystem. Representative Philip Sharp, Chair of the House Energy and Commerce Subcommittee on Fossil and Synthetic Fuels, asked the Commission for data on the impact of the *Mid-Louisiana* decision after the Supreme Court had ruled. Sharp said that he was "extremely concerned" and asked the FERC about the pipelines that were affected, the amount of gas involved, and the effect in revenues for each pipeline and for the country. After receiving a response from the Commission (with an estimate of $162 million as the impact of the decision for 1983), Sharp wrote to each of the pipelines to ask them to hold down prices and to "assess with the utmost diligence and care" their response to the Court’s decision.

See "Rep. Philip Sharp Wants Figures from FERC on the Impact of the Mid-La Decision," *Inside F.E.R.C.*, July 25, 1983, p. 2; and "Total ’83 Impact of Pipeline-Production Decision is $162 Million, Says FERC," *Inside F.E.R.C.*, August 22, 1983, pp. 1, 4b. In his letter to the pipelines, Sharp wrote that "many members of Congress are inclined to deal very strictly with the production of companies affiliated with pipelines in order to ensure that pipelines are not treating non-affiliated producers inequitably." There is no indication of what impact, if any, Sharp’s letter may have had.

With respect to the impact of the court ruling other figures can be mentioned. In oral argument before the Supreme Court, FERC Solicitor Jerome Feit stated that interstate pipelines would be able to raise their rates by approximately $200 million per year or between $2 and 3 billion (continued...
Likelihood of penalties for noncompliance do not appear to be very significant in this case. An OPPR staff member observed that the Commission was not very concerned about the possibility of additional litigation. The staff member noted that "once the Supreme Court said what they said ..., the decision and the regulations were then adopted ... to be as consistent with that decision as necessary." There was "no real consideration" given to opposing views because the Supreme Court had ruled and all parties would have to live with that decision. The Commission did not feel that it had a lot of discretion.

There are two possibilities for why penalties for noncompliance may not be crucial here. The first involves agency view of the court. As stated by the OPPR official, the FERC believed that it had to respond in a certain manner as prescribed by the High Court. It could not worry about the possibility (or threat) of penalties for noncompliance as it fashioned its response. Another related point made by respondents in some of the other case studies in this chapter is that litigation is so frequent (i.e. an expected way of doing business in the subsystem) that the Commission could not be distracted by it if other concerns, such as obeying the Supreme Court, were present.

Disruptiveness of the court order was apparently low in this case. An OPPR staff member did not feel that Mid-Louisiana was as disruptive as the INGAA decision. In that latter case, "rates were in effect wrongly and had to be given back." She noted that "any time the Commission is reversed and there's refunds, it causes major disruptions." In

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over the remaining life of the gas reserves to which the ruling would apply. See Jerome Feit, "Court Update," *FERC Monitor*, April 4, 1983, p. 7. It was also reported that the ruling would affect eighteen pipelines. See "Commission to Implement Rules for First Sales of Pipeline-Owned Natural Gas," *FERC Monitor*, December 29, 1983, p. 12.
Mid-Louisiana, the Commission had not allowed the pipelines to levy certain higher charges and there were thus no refunds to be made. Some disruption might have resulted from the pipelines making special billings or filings to collect the higher prices from past periods. That type of disruption was minor compared to the problems resulting from refunds. After the Supreme Court ruled that pipeline production was entitled to the higher prices, pipelines were eligible to reprice their gas retroactively back to the effective date of the NGPA which was five years earlier than the Court's decision. This resulted in some large price increases for consumers.11

The findings presented above are in line with behavior predicted by some of the hypotheses discussed in Chapter 1 (and repeated above). It is hypothesized that higher agency commitment to the program should lead to less faithful implementation of the court order. In this case, high agency commitment to the program under review was an important factor in evasion of the court order and a decision to appeal. At the same time, the FERC proceeded to implement an order overturning a policy to which it was highly committed. Commitment thus only goes so far in accounting for agency actions in Mid-Louisiana especially when confronted with an important counterforce.

Agency view of the court, reinterpreted as court as legitimate authority to be obeyed, is that counter and is perhaps more influential

11 The Phillips case was not a major development according to the OPPR staff member. Phillips appeared to be the only party harmed or likely to be harmed by the Commission's response to the Mid-Louisiana decision. The company's claim "didn't seem to make a lot of sense" to the Commission which "never quite understood Phillips's concern." The Commission's approach was that it was only implementing the Supreme Court's ruling. Phillips appeared to be contending that some parties were getting benefits from the higher prices but they were not. The staff member felt that the Phillips ruling was not disruptive for the FERC.
than commitment in explaining the actual agency response. The view of
court as legitimate authority is positive and in line with the expectation of
positive view leading to more faithful implementation. At the same time,
the court is not necessarily seen as a friend (friendliness is another
dimension distinct from legitimacy; the court is more of an overseer or
guardian) so that implementation might still occur even though the court
is not viewed in friendly terms. The importance of agency view over
commitment in accounting for implementation or evasion would not have
been expected from the hypotheses and framework laid out in Chapter 1
and is very interesting.

Another interesting finding is the role of likelihood of penalties for
noncompliance. As hypothesized, greater likelihood and severity of
penalties for noncompliance should lead to more faithful implementation
of the court order while lesser likelihood should lead to less faithful
implementation. In *Mid-La*, the FERC apparently did not feel that
there was any likelihood and severity of penalties for noncompliance or
did not feel bound by any such penalties because the Commission (view­
ing the court, particularly the Supreme Court, as legitimate authority to
be obeyed) felt that it had to follow a prescribed course and set out to
implement the Court's order. The perception of any penalties was
overwhelmed by other concerns (the duty to obey the court). The fre­
quency of litigation, blunting its effectiveness as a penalty, may have also
been a factor here.

The findings concerning the other two independent variables
appear to be in the hypothesized direction. There was low disruptiveness,
probably a factor in implementation. External pressure was important
during the course of this case and certainly pointed in the direction that
the FERC eventually followed. The Commission's response to the court
order, however, was fairly straightforward and was more a function of the
Comments can also be made on some of the hypotheses or statements concerning the interrelationship of various independent variables. In \textit{Mid-La}, there appears to have been no major effect of external pressure on agency commitment during the rulemaking process and thus no support for that particular statement. As expected agency commitment did override disruptiveness and likelihood of penalties as a force in determining agency response to the court partly because disruptiveness and perception of penalties were both low but contrary to expectations (and as discussed above) agency view of the court was more influential than commitment. Finally, greater agency commitment might have resulted in less of a role for external pressures but both were secondary to view of the court.

\textbf{The INGAA Wet/Dry Rule Case}

The Commission's response to the court order in this case, as described in Chapter 3, consisted initially of implementation with some evasion of the full consequences of the order including defiance in the form of an appeal. Implementation proceeded after the second \textit{INGAA} ruling. The FERC response was characterized by high commitment to the program seen for example in the Commission's actions to apply retroactively and defend in court the dry rule; high perceived disruptiveness as shown by FERC attempts to cushion the industry (through the use of offsets) from the effects of the court order; major external pressure characterized by high levels of group litigation and lobbying; positive view of the court as legitimate authority to be obeyed; and some concern about perceived penalties for noncompliance as the Commission decided on the refund procedure and debated the use of
offsets. Not only are many of the independent variables influential in the INGAA case but they also clash with each other (commitment versus disruptiveness being a good example) as shown below.

**Commitment on the part of the FERC to its policies** (both the dry or as delivered rule and the refund order) is a significant factor in this case. As in *Mid-Louisiana*, the Commission’s view of its role and obligations under the law was an important part of its commitment. In this instance, the obligation was to insure that proper, lawful prices were paid for natural gas.

The Commission’s regulations, described in Chapter 3, show that the FERC believed that the dry rule was mainly a technical provision ensuring that the regulations under the Natural Gas Act (NGA) and the Natural Gas Policy Act (NGPA) corresponded. As when it ordered the refunds of the amounts paid under the dry rule, the Commission believed that that rule was its duty under the NGPA. The NGA had mentioned cubic feet of delivered gas but in the NGPA Congress had used British Thermal Units in setting maximum prices in order to compare the energy content of gas with oil. For the NGPA prices to correspond with the NGA, the Commission reasoned that gas had to be priced on an as delivered basis instead of the old standard condition that contained a larger amount of water vapor. A mere technical correction for FERC was, however, a major transfer of funds from pipelines and distributors to producers.

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12 A member of the Commission at the time remarked that this case was a clean-up, involving an issue that Congress had missed. The FERC thus had to deal with it. It was not monumental to the structure of the gas industry in his view.

13 See, for example, Rules Generally Applicable to Regulated Sales of Natural Gas; Order Denying Rehearing and Clarifying Order No. 93; (continued...)
Before adopting the dry rule, the Commission had to resolve some disagreements over how to proceed with its implementation. One such disagreement between the technical (OPPR) and the legal (Office of General Counsel) staffs concerned the timing of the shift from the wet to the dry rule and not whether the change should be made. The OGC staff was concerned that proper notice of the modification had not been given and argued that the rates could not be made effective until after petitions for rehearing had been handled. Their view was that the change in price could only be prospective and not retroactive. The OPPR staff argued that the NGPA intended for prices to be based on millions of Btu's and that the statute had been in effect since December 1, 1978. The regulations and price change thus should have been in effect since that time. The technical staff argument prevailed (probably reflecting the sense of

13(...continued)
Docket No. RM80-33; Order No. 93-A; Issued April 24, 1981, 46 Fed. Reg. 24,537 (May 1, 1981) at pp. 24,539-24,540. Interestingly, the Commission also remarked on p. 24,542: "given that the NGPA pricing scheme is a significant departure from past Commission and industry practice, it is not surprising that its implementation has created confusion both for sellers and purchasers." The Commission said that the rule did not require the industry to modify its measurement or pricing practices.

The Commission’s comments in its brief defending the dry rule to the D.C. Circuit Court are in line with the points just made about its commitment to the program. The FERC argued that the wet rule would result in "inaccurate pricing under a statutory scheme where accurate pricing on an energy basis is a hallmark...." The wet rule had been adopted "as a discretionary matter" under a different pricing arrangement and was an "imprecise method" for measuring energy content. The dry rule, however, was consistent with NGPA language calling for pricing "per Btu of gas delivered." See "United Seeks Ruling on Btu Adjustments as Other Pipelines Answer FERC," Inside F.E.R.C., June 21, 1982, p. 9.

A former senior official of Office of Pipeline and Producer Regulation noted that this case basically involved an interpretation of congressional intent in establishing maximum lawful prices. The question involved the meaning of "as delivered." Thus, this was a technical case rather than a major policy.

282
duty felt by the FERC to insure that proper prices were paid) although an OPPR staff member felt that the outcome of the case in the D.C. Circuit would not have differed even if the FERC only had applied the rule prospectively.\(^4\)

Similar to its view of the necessity of the dry rule, the Commission decided on a refund process in responding to the first \(INGAA\) ruling (and thus providing a basis for the second \(INGAA\) ruling) because it felt that such was its statutory obligation under the Natural Gas Policy Act.\(^5\) The Commission's duty was to insure that only NGPA mandated ceiling prices were paid. On the same day that the FERC issued its order reinstating the "wet rule" for measuring the Btu content of gas for pricing purposes, it issued a notice of inquiry to begin the refund process. Apparently there never was any doubt among the Commissioners that refunds were necessary. As noted below in the comments of an OPPR staff member, the necessity of refunds was not questioned. In the notice of inquiry, the FERC stated that "as a result of the court's opinion lower payments should have been made for gas sold under the NGPA since

\(^4\) A staff member from the Office of Pipeline and Producer Regulation (OPPR) remarked that both staff and commissioners were split over the "wet" vs. "dry" issue. The rule was on the agenda of three or four Commission meetings as the commissioners discussed the implications and options. But once the Commission approved the order, both commissioners and the staff supported it because it was the law and was to be implemented.

An indication that support for the dry rule apparently was not unanimous within the staff is seen in the remarks of a former senior official of the OPPR. He stated that the court had acted correctly in striking down the rule. The FERC "was reaching to give the producing industry a little extra money ... over ... what really was truly mandated by the NGPA."

\(^5\) Note that while this is technically an agency response to the court, it also is a new policy to which the FERC might or might not be committed.
December 1, 1978. Thus, any seller that priced its gas on the basis of the actual Btu content of the gas delivered to the pipeline was overpaid and must refund the overpayments.\textsuperscript{16}

When the Commission issued its final rule, it discussed commenters' objections to ordering refunds. As described more fully in Chapter 3, the FERC concluded that it was legally required under the NGPA to order refunds. Failure to do so would have in effect established higher ceiling prices than those provided for in the law and the NGPA allowed the FERC to set higher prices only in very limited circumstances. Thus, despite the burdens associated with refunds, the FERC was bound to proceed with that policy.\textsuperscript{17}

The disruptiveness of the court order was a very important factor here. An important point is that "disruption" refers to disruption for the

\textsuperscript{16} See Refunds Resulting from Btu Measurement Adjustments; Notice of Inquiry; Docket No. RM84-6-000; Issued January 19, 1984, 49 Fed. Reg. 3,198 (January 26, 1984) at p. 3,199.

\textsuperscript{17} See Refunds Resulting from Btu Measurement Adjustments; Final Rule; Docket Nos. RM84-6-000, RM84-6-001, and RM84-6-002; Order No. 399; Issued September 20, 1984, 49 Fed. Reg. 37,735 (September 26, 1984) at p. 37,737.

An OPPR staff member noted the problems that had arisen from industry relying on the "dry rule" and then having to refund the overcharges. Some administrative problems were created for the OPPR as it oversaw the refunds. For example, producers would claim that they did not have the money or did not have a relationship with parties from whom they had to obtain funds. The staff member agreed with the Commission that the refunds were necessary above and beyond reinstating the "wet rule" because the FERC had to comply with Title I of the NGPA. While the offset procedure was an attempt to minimize the disruption to the industry of the Btu refunds, the staff member felt that the court was probably correct in its view that the offsets introduced complexities into the refunds.
industry moreso than for the FERC although the Commission also had problems overseeing the refunds.¹⁸

The Commission's view of its legal obligations under the NGPA clashed with the needs of some of its members to ease the disruptive burden of refunds. Disruptiveness viewed as disruptiveness to the industry or to parts of the natural gas policy subsystem impacted upon agency commitment. Although the relationship between disruptiveness and commitment is the object of one of the minor hypotheses stated above, it is a major part of this case and is treated more prominently here. As shown below, this disruptiveness was communicated to the FERC by producers. Thus, the linkage between variables in this part of the case might be seen as disruptiveness of the order (for the industry) to external

¹⁸ A former senior OPPR official stated that this case was the most disruptive of the five being studied here because the rule had been implemented and then refunds had to be required to undo it. The Commission had to spend a large amount of effort to implement the ruling and had not been able to guarantee that all refunds had been made. An example of the difficulty facing the Commission can be seen in the comments of a staff member from OPPR in an interview in June 1988. She observed that the Commission was still implementing the refund rule and estimated that $2-3 billion had been refunded up to that point with about $50 million still to be refunded by many small producers.

The OPPR staff member described various reasons for the disruptiveness (for the FERC and the industry) of refunds. Producers' markets were not as healthy at the time that they would be making the refunds as they had been when the producers had collected the higher prices. Some small producers did not have the money to return and some had gone out of business and could not be located. Although it had estimated that several thousand producers would have to make refunds, the Commission did not have a list of the producers and did not know the amount that each producer would have to pay. The FERC had limited resources and information to implement the refund procedure. Twenty staff members worked in the refund area and "Btu refunds aren't the only thing they do." The process had been very disruptive and in the words of the staff member, "the refunds were all supposed to have been paid by the end of '85 and we're still living in the middle of '88 with approximately 2,000 non-producers alleged by the pipelines not to have made their Btu refunds."
pressure to agency commitment (to a strict refund policy and the use of offsets) to agency response to the court (offset mechanism).

For most of its existence since 1977 as the Federal Energy Regulatory Commission, the FERC has had members from gas producing states. In 1984 when it was considering how to implement the *INGAA* decision, the Commission had two such members: J. David Hughes from Texas who left the FERC in July of that year and Oliver G. Richard III from Louisiana. Both of these Commissioners, especially Richard, were vocal advocates of easing the pain of refunds for producers.19

The FERC approved a final rule, Order No. 399, governing refunds in September 1984. Richard was concerned about producer collection of refund amounts from royalty owners and he argued with Commission attorneys over provisions of the rule requiring producers to try to collect certain amounts that were acknowledged to be uncollectable. In Order No. 399, the FERC stated that producers still should "make every effort

19 The pro-producer stance of Commissioners Richard and Hughes was evident at various times during the Commission's consideration of refunds. For example, when the FERC was developing the interim rule in April 1984 both Commissioners expressed concern about the ability of small producers to collect refunds from resistant royalty owners (those who owned the land from which the gas was extracted). Richard said that "we don't want to change small drilling operators into collection agencies." The Commission decided to give the smaller producers extra time to make refunds. See "FERC Gives Small Producers a Break in Settling on Btu-Refund Procedure," *Inside F.E.R.C.*, April 30, 1984, p. 3. In the interim rule, the FERC decided to give small producers (those who had sold 10 million Mcf of gas in both the intrastate and the interstate markets in 1983) twelve months to make the refunds. Larger producers were given six months. See Refunds Resulting from Btu Measurement Adjustments; Interim Rule; Docket No. RM84-6-000; Issued May 3, 1984, 49 *Fed. Reg.* 19,293 at p. 19,295 (May 7, 1984).
to collect and pay the entire Btu refund within the appropriate... time limits.°

Richard stated that there were over two million royalty owners from whom refunds were to be collected. However, the Commission had estimated that six percent of these refunds would be uncollectable. The Commissioner asked why the producers should even try to collect such amounts. He suggested that producers should be allowed to submit an affidavit at the outset stating that the royalty owners cannot make the refunds instead of having to apply for a waiver of the regulation. Staff from the Office of General Counsel argued that refunds would have to be made in order for the prices paid for gas to meet the NGPA maximum prices. The rule would be "hammered" by an appeals court if the FERC did not attempt to guarantee that refunds were collected."¹

Producers voiced complaints and frustrations with the refund rule. Less than a month after Order No. 399 had been issued by the FERC, eighteen large producers requested a rehearing claiming that the Commission had "misconstrued controlling statutes, acted arbitrarily and capriciously, reached conclusions not based upon substantial evidence,

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²⁰ Order No. 399, 49 Fed. Reg. 37,735 at p. 37,740 (September 26, 1984).

²¹ See "Commission Clears Final Btu-Refund Rule Despite Richard's Objections," Inside F.E.R.C., September 17, 1984, pp. 1, 4-5. This last quote is a clear indication of perceived penalties for noncompliance. Some further quotes from this story show the extent to which the Office of General Counsel and the Commissioners felt constrained and frustrated by the courts and the law as to what they could or could not do here. The Commission's General Counsel, arguing for the provisions requiring producers to make the effort to recover amounts from royalty owners, stated that "we have to exhaust every effort to collect before we forgive [a] repayment obligation." Richard asked, "you mean we have no discretion in ordering refunds?" The General Counsel replied, "that's what Congress seems to have said...." The other Commissioners expressed frustration with the approach but all except Richard voted for the rule.
abused its discretion and... failed to engage in reasoned analysis of the comments filed." The producers were also upset that the Commissioners had not allowed them to offset Btu refunds against the production related costs owed them by the pipelines.22

The FERC had addressed the issue of offsets in Order No. 399, noting that many of the commenters discussing the idea were in favor of it. However, for various reasons the Commission did not allow their use. Offsets were being conducted through a separate procedure and the FERC wanted to keep them separated from the Btu refunds. Offsets might also prevent the Btu refunds from reaching the customers that were actually overcharged under the "dry rule." In addition, the Commissioners felt that "permitting offsets... would complicate an already difficult process and would make Commission monitoring of Btu refunds more difficult."23

Like the producers, Commissioner Richard favored the use of offsets. Richard continued to oppose the Commission's view that producers had to make major efforts to collect and refund every dollar paid under the "dry rule." In his view, the Commission should have recognized that only "substantial compliance" might be possible in some instances and that some refunds would be impossible to collect because producers or royalty owners were unable to pay for reasons such as bankruptcy or death. Richard asserted that the right to refunds should not "justify the

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22 See "Major Producers Want More Time to Make Btu-Adjustment Refunds....," Inside F.E.R.C., October 15, 1984, p. 10. The comments of the producers illustrate how battle lines and coalition memberships can change in regulatory controversies, even within the same case. The producers and the FERC were allies in this particular policy area up through the INGAA ruling. Faced with the implementation of that order, they became adversaries.

23 See Order No. 399, 49 Fed. Reg. 37,735 (September 26, 1984) at pp. 37,738-37,739.
imposition of extraordinary burdens of collection or reimbursement on the [producer] under all circumstances." The costs of making refunds had to be considered and the process "should be accomplished with, at the least, a manageable amount of trauma to the industry." 24

In November 1984 the Commission issued Order No. 399-A, adopting the offset procedure advocated so forcefully by Richard and the producers and also by some pipelines. The Commission took this action over the objections of two of its members, Chair Raymond O'Connor and Anthony Sousa. Both dissenters expressed concern that the new rule was not following the D.C. Court's order. Sousa said that the rule was "mixing apples and oranges" and was a "circumvention" of the INGAA ruling. O'Connor was reluctant to "climb over the mandate of the court." Noting that the rule dealing with production related costs was still being litigated in court, the FERC Chair argued that "we do not have an offset. On one side we have a refund clear and owing" from the INGAA decision, but on the other side "it's indefinite as to the amount" owed. The majority, however, stated that the offsets would ease the transition that the market

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24 In a partial dissent to Order No. 399, Richard had argued that offsets would be "an equitable and efficient means of effecting the exchange of money owed." The offset would also reduce the administrative costs of Btu refunds and production related costs and would thus benefit consumers. See "Commission Stays Effective Date," FERC Monitor, November 15, 1984, pp. 8-9.

Richard also felt that the view that the FERC would be condoning prices higher than the NGPA maximum if it did not enforce the collection of every dollar owed was "misguided." See "Commission Stays Btu Refunds; Richard Proposes Collection Procedure," Inside F.E.R.C., October 29, 1984, p. 8. This article also mentions a letter sent by a small producer in Texas to the Commission. The producer attacked the refund rule, saying "the small, independent operator will be stuck with a bill he cannot afford and has no method of collecting." The royalty owners are "scattered all over the world, dead, bankrupt, insane and not interested nor concerned with repaying a gas-production overpayment on wells that have long ago been plugged and abandoned."
would undergo when NGPA-mandated decontrol of a large portion of gas production occurred the following January.25

Commissioner Richard was able to gain Commission approval of the offset procedure, but he was still unable to persuade a majority that producers should be excused from trying to collect uncollectible refunds from royalty owners. The Commission did agree to consider producer requests for waivers from this requirement on a case-by-case basis. In dissenting from this part of the rule, Richard stated that the Commission would not be able to restore completely the status quo ante and that substantial compliance with the refund mandate of the INGAA ruling while balancing equity and the public interest was the best that could be expected. Richard asserted that "not every decision invalidating an agency order should be given full retroactive effect" and that some of the problems arising with the refund process were due to the Commission's "erroneous interpretation of the NGPA that the Court corrected."26

While disruptiveness of the court order clashed with agency commitment, another important motivation for Commission action here was positive view of the court in the sense of court as legitimate authority to

25 Note in the description of this meeting that the motivations of legitimacy of the court and perhaps penalties for noncompliance expressed by Sousa and O'Connor clashed with disruptiveness and external pressures. See "In Reversal, FERC OKs Offset of Btu Refunds, Production-Related Costs," Inside F.E.R.C., November 19, 1984, pp. 1, 5-6. Richard said that Order 399-A would enable the FERC "to assure the industry and consumers that market response will be forthcoming." The rule would "clear the decks for 1/1/85," the date when a large portion of gas production was to be deregulated under the NGPA. Commissioner Charles Stalon, who voted for the offset, said that "it's important that the price in the market reflect the price at the wellhead and not past events."

26 See Refunds Resulting from Btu Measurement Adjustments; Order Granting in Part and Denying in Part Rehearing; Docket Nos. RM84-6-003 through 014; Order No. 399-A; Issued November 20, 1984, 49 Fed. Reg. 46,353 (November 26, 1984) at p. 46,363.
be obeyed. As mentioned above in Chapter 3, the Commissioners in Order No. 399 noted their obligation to implement the first INGAA decision. The duty to obey meant obedience to both the court and the law (or the law as interpreted by the court). Thus, positive view of court complemented that aspect of agency commitment to policy dictating that only proper lawful prices were to be paid for natural gas. A staff member from the OPPR remarked that once the court had overturned the dry rule, the course that the Commission had to pursue was clear as it had been in the Mid-Louisiana case. The FERC had to reinstate the wet rule effective retroactively to December 1, 1978. That was "relatively cut and dry" and there was no controversy.

But, the OPPR staff member remarked, the Commission had to consider other issues. The main cause of disruption derived from the fact that "some producers had collected five years' worth of prices that were no longer allowed" and the Commission had to decide whether to order refunds and if so, how to do it. As described above, the Commission's subsequent approval of the offset was an attempt to ease the disruptiveness of the refunds and the court order. In the eyes of Commissioners

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27 The staff member did not feel that the Commission would defy the court. Once the court has ruled in a case and the Commission realized that the decision was final, the commissioners would feel compelled to act accordingly. In the Mid-Louisiana and the INGAA cases, it was clear that the Commission had to respond in a certain way. In other instances if the court has given indication that it might uphold the policy for other reasons, the Commission might try to develop the other reasons. The Phillips case would be an example.

Remarks by two members of the Commission at the time are in accord with the staff member's observations. One former commissioner said that the FERC would not consider defiance although the Commission may appeal to the "nth degree" especially if it was felt that the court would stay its decision. The other commissioner remarked that the FERC went along with the court because the agency had been "beat in the head" enough times in this case.
O'Connor and Sousa that action also represented a slap at the court, the legitimate authority that the FERC had to obey.

Again indicating both the need to obey the court and the law while balancing the disruptive potential, the OPPR staff member also noted that there was no division among the staff on whether refunds had to be made. It was a "clear call that we did not have the discretion ... across the board to say 'no refunds'..." Refunds had to be ordered "universally," but there were concerns that the producers' markets were not as sound, that prices had fallen, and that some producers had gone out of business. There was discussion of the standards that the FERC might adopt to exempt producers on a case by case basis from refunds but there was no discussion of a blanket exemption for all producers.\footnote{According to the staff member, the commissioners approved the offset procedure because producers persuaded them that they were having problems in making the refunds. Also, producers argued that it was unfair that they had to make refunds while the pipelines owed production related costs to them. The commissioners were more sympathetic but the staff opposed the offset because it would have been easier to monitor the Btu refunds without it. The staff member observed that "... a lot of times staff recommends what they think is best and we don't always win. In this case we did not win."}

As mentioned above, there was major external pressure on the FERC in this case. The different industry segments represented mainly by their respective interest groups were fighting a billion dollar battle at the FERC with one segment, producers, winning the initial round at the Commission. Subsequent rounds were won in the courts by the pipelines and distributors. The discussion below contains an overview of the positions of the various interests and an illustration of subsystem politics as this case developed. It admittedly appears to blur at times the distinction between external pressure and agency response to the court as interest group litigation was part of the post-court order actions. That
blurring was felt to be necessary, however, to show the full picture of subsystem politics in this case.

Producers had complained to Commission staff that the existing standard for measuring the energy or Btu content of the gas, the "wet" rule, forced them to undercharge for the fuel. Staff believed that the pipelines were paying for the actual delivered Btu content of the gas. However, the pipelines' complaints about the dry rule indicated that they assumed that the gas contained more water vapor than the producers claimed and that they thus were paying less for it than the producers believed that they should.²⁹

The Interstate Natural Gas Association of America (INGAA) stated that it would be very difficult for pipelines to pay on the basis of actual delivered Btu content. INGAA claimed that the water content varied over time and that pipelines would have to install expensive measuring devices at each point of delivery to monitor the water content. INGAA also claimed that Congress had assumed that the gas was saturated with water vapor when it devised the pricing mechanisms of the Natural Gas Policy Act (NGPA). Switching to the dry rule would raise prices above what Congress had intended. This last argument, it might be recalled, was particularly persuasive for the D.C. Court of Appeals.³⁰

The Commissioners rejected these pipeline arguments, however, agreeing with FERC staff that Congress adopted energy content as the pricing mechanism because NGPA prices were listed in dollars per millions of Btu's. The Act set the price of gas in relation to the price of crude oil. Staff maintained that Congress could not have compared the


³⁰ Ibid., pp. 9-10.
price of gas with the price of oil without comparing the energy contents of the two fuels.\textsuperscript{31}

Echoing the arguments that an OPPR staff member said had been made by the Office of General Counsel, pipelines and distributors asked the Commission not to apply the rule retroactively back to December 1, 1978, the effective date of the NGPA. One distributor claimed that it would have to pay its pipeline supplier $25 million in retroactive payments. Both INGAA and the Associated Gas Distributors (AGD) asked the FERC to apply the rule prospectively. AGD asserted that purchased gas costs would "balloon" from retroactive application.\textsuperscript{32}

Producers stated that changes in the dry rule would "constitute nothing less than a reduction in the maximum lawful price established by Congress." The Commission, the producers said, "simply does not have that power" to order such reductions. The producers also argued for retroactive application, stating that "the commission was merely carrying out its statutory duty to require the pipeline purchasers to pay for all of

\begin{footnotesize}
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  \item Again illustrating the intricacies of subsystem politics, the pipelines and distributors were not always in agreement in the early stages of this case. For example, AGD opposed the efforts of some pipelines to collect from their customers the higher gas costs resulting from the dry rule. For one case, see "AGD Asks Court to Stay FERC Order Permitting Tennessee's Btu Adjustment," \textit{Inside F.E.R.C.}, August 16, 1982, p. 7; and "Appeals Court Denies AGD Request for Stay of Tennessee's Btu Adjustment," \textit{Inside F.E.R.C.}, August 30, 1982, p. 7.
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the Btu they were receiving...." The FERC was implementing a new law from its effective date and was carrying out the mandate of Congress.33

After the D.C. Court of Appeals overturned the dry rule, producers were in the forefront of the effort to appeal that decision. One attorney representing the producers said that his parties were planning to seek rehearing of the order by the D.C. Court and, if necessary, the U.S. Supreme Court. The attorney also said that the producers did not want to be "out of sync" with the FERC and any action that the producers would pursue would depend on what the Commission decided to do.44

Producers and the FERC both appealed to the Supreme Court which decided not to hear the case.35

33 See "Producers Wade Back into Battle over Adjusting Prices for Btu Content," Inside F.E.R.C., November 16, 1981, pp. 8-9. The producers asked for oral argument on the issue because "this issue appears to have become quite complex. It is certainly important."

34 See "Producers Unlikely to Leave Unchallenged Refunds for Btu Adjustments," Inside F.E.R.C., August 15, 1983, pp. 1-2. While the producers' attorney said that the court had substituted its own judgment for that of the FERC, an attorney for INGAA called the ruling "a very good decision for pipelines and consumers."

35 See "Producers, FERC Want Stay of Btu-Content Order; Distributors Want Relief," Inside F.E.R.C., December 19, 1983, p. 3. See also "Court Denies Stay of Btu-Content Ruling but Doesn't Forbid Another Try," Inside F.E.R.C., January 9, 1984, p. 3. Eighteen producers, along with the Solicitor General on behalf of the FERC, filed for a stay of the D.C. Court's ruling. The producers claimed that the case "presents issues of fundamental importance regarding the authority of courts to override a reasonable statutory interpretation" by an agency. Chief Justice Burger denied the motions for a stay on December 30, 1983. The producers and the Commission then filed motions for a stay and for certiorari. The producers argued that the appeals court should have decided whether the Commission's interpretation was reasonable and not substituted its own construction of the law. The problems for the industry, both economic and administrative, in implementing the D.C. Court's order were mentioned by the producers and by the Solicitor General in their appeals to (continued...)
The interest groups continued to spar through the rulemaking undertaken by the FERC to implement the D.C. Court's decision. The Commission, as described in Chapter 3, proceeded to reestablish the "wet rule" as the official standard and to order producers to refund any excess amounts that they had collected under the "dry rule." The various groups offered their ideas to the Commission on how to proceed. INGAA, for example, stated that pipelines should not have to make any refunds to their customers until producers had paid the overcharged amounts to the pipelines. Producers claimed that pipelines should have to provide invoices that set forth exact amounts due under specific contracts.

The Associated Gas Distributors, on the other hand, objected to the whole idea of a rulemaking with its multiple stages and argued that the FERC was engaged in "administrative footdragging" that would delay the process of making refunds to customers. On more than one

(...continued)

the Supreme Court. The producers referred to "economic disruption" and to the administrative burden of making the refunds to pipelines. The Solicitor General noted the "disruptive effects" of the D.C. Court's order. See "Court Denies Stay of Btu-Content Ruling but Doesn't Forbid Another Try," Inside F.E.R.C., January 9, 1984, p. 3; see also "FERC and Producers Last Week Asked the Supreme Court to Consider....," Inside F.E.R.C., January 23, 1984, p. 2. The Supreme Court denied certiorari on March 19, 1984. Reported at 465 U.S. 1108. Justice White would have granted certiorari.

See "AGD Has Charged the Commission with 'Administrative Footdragging'.....," Inside F.E.R.C., February 20, 1984, pp. 8-9; "Any Btu-Adjustment Refunds Should be Kept as Simple and Risk-Free for Pipelines.....," Inside F.E.R.C., February 27, 1984, p. 9; and "Producers, Pipes Offer Ways to Minimize Impact of Btu-Adjustment Refunds," Inside F.E.R.C., March 12, 1984, pp. 8-9. At a conference held at the Commission in May 1984 producers, pipelines and other parties expressed their concerns before Commissioners Richard and Hughes and FERC staff. Producers argued that they did not have sufficient information to calculate the refund amounts and stated that pipelines should be required (continued...)
occasion the distributor trade group went to the D.C. Court asking it to enforce its ruling in the INGAA case. As noted in the previous chapter, one such instance was when the FERC had decided to allow producers to offset the Btu refunds against certain costs owed them by the pipelines. The AGD also had gone to the court several months earlier to complain about the rulemaking proceeding and to ask for an order directing the Commission to comply. As with the pipelines in the Mid-Louisiana case, the AGD felt it necessary to turn to the courts to achieve its policy goals when the FERC would not listen or would not move quickly enough.

The rulemaking that the FERC undertook to find solutions to the refund problem resulted in some divisions among the Commissioners over how to proceed with the refunds (i.e. offsets) and as described above

\[\text{\ldots(continued)}\]

to provide such data. Producers also were upset over having to obtain refund amounts from royalty owners and stated that there would be major difficulties in cases where those owners were federal or state agencies. Conference participants suggested that the Commission explore other methods besides refunds, such as the offset procedure. See "Producers, Pipelines Air Concerns about Btu Refund Rule," FERC Monitor, June 14, 1984, pp. 13-14.

\[36\text{See }"\text{AGD Has Asked an Appeals Court to Prod FERC into Action on Refunds...." Inside F.E.R.C., April 2, 1984, p. 6. The AGD called the rulemaking "unnecessarily protracted." The group felt that the Commission should issue an interim rule, effective immediately, in the same proceeding reestablishing the "wet rule." The FERC could also provide opportunity for public comment on and revision of this rule. One month later the Commission did issue an interim rule effective immediately, although it is not at all certain that this action was taken in response to the objections of the AGD. The Commissioners stated that the interim rule was necessary because some pipelines had begun to initiate their own refund programs without the consent of the producers. A rule was needed immediately "to prevent a disorderly refund process and to provide the Commission with the necessary information to monitor that process." See Refunds Resulting from Btu Measurement Adjustments; Interim Rule; Docket No. RM84-6-000; Issued May 3, 1984, 49 Fed. Reg. 19,293 (May 7, 1984) at p. 19,298.\]
further litigation and defeat for the Commission in the D.C. Court. As just mentioned, each of the various groups had its own ideas on how the Commission should proceed. The fact that this case pitted segments of the industry against each other in a way that few other cases do (in terms of revenues) made the issue very contentious.  

It is not surprising that AGD or INGAA or other groups may have felt it necessary to go to court. In examining the various documents that the Commission issued during this case, the various rules, notices of rulemaking or inquiry, etc., one sees a similar pattern to that described in other cases such as *Mid-Louisiana*. The Commission discussed comments at length usually to explain why it was not taking the proposed change.

In the whole sequence of events Order No. 399-A appears to be the main instance of the Commission taking suggestions from outsiders. The offset procedure was implemented and the Commission agreed to waive producer obligations to collect uncollectible refunds on a case-by-case basis. In this instance there was a strong advocate of such moves on the Commission and this undoubtedly had some effect even though that Commissioner still did not secure FERC approval for everything he wanted. With the exception of Order No. 399-A, the FERC did not make

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38 An OPPR staff member recalled that producers argued that the Commission had the discretion not to order refunds as they had only collected prices that were legal at the time. Pipelines and distributors argued that refunds had to be ordered as the prices charged had exceeded what would have been charged under the wet rule. With respect to involvement by other outsiders, the staff member was not aware of any comments filed by members of Congress in the rulemaking that resulted in the refund process. As refunds had been pursued from producers, members might have intervened on behalf of certain constituent producers. The staff member also did not recall any involvement by the Department of Energy in this case. The Department's involvement at the FERC appeared to be concentrated on larger policy concerns such as a rule on the pricing of old gas.
any major changes in what it intended to do as a result of outside parties' comments.

Litigation thus became the only way for some parties to effect change and the Commission apparently realized this. About one month before issuing Order No. 399-A, the FERC granted a stay of Order No. 399. In the order granting the stay and rehearing, the Commissioners stated "with respect to the petitions for rehearing, we are concerned that all parties to this proceeding who may desire judicial review of Order No. 399 have an opportunity to seek such review of our final disposition of the petitions for rehearing on the merits." As noted in the discussion of the Mid-Louisiana case, judicial review is an established part of the FERC rulemaking process, the importance of which the Commission itself recognizes.

An interesting alignment of interest groups, pipelines and producers on the one side against distributors and consumers on the other, resulted from the D.C. Circuit Court's decision on March 5, 1985 to vacate the offset mechanism. The Associated Gas Distributors argued that offsets would be at the expense of the consumer and requested the D.C. Court to order the Commission to comply with its original mandate in the INGAA case. When a three-judge panel did so, however, pipelines and INGAA were among those unhappy with the court's order. Pipelines had used the offset to settle their accounts with the producers and the court's decision would thus nullify hundreds of accounting transactions. One pipeline official said that "everything was done, everybody was tickled to death." But with the court's order, "the producers will owe me money, I'll have to give it to the customers, we'll owe the

39 See Refunds Resulting from Btu Measurement Adjustments Issued October 24, 1984; Docket Nos. RM84-6-003 through RM84-6-014; Order Granting Stay and Rehearing for Purpose of Further Consideration, 49 Fed. Reg. 43,543 (October 30, 1984) at p. 43,544.
producers money, and I'll have to put it in my rates." The Process Gas Consumers Group was "ecstatic" with the decision. PGC had argued that the offset constituted retroactive ratemaking, modifying approved rates outside of a rate case.40

Producers and the INGAA soon thereafter asked the full court to rehear the decision of the three-judge panel. The producers argued that the panel had granted judicial review to the AGD even though the distributor group had not first sought review at the FERC. The panel also "improperly invaded" the discretion of the Commission to derive refund procedures. INGAA argued that the court had improperly substituted its views for those of the FERC. Supreme Court precedent, however, "emphasized that Congress has entrusted the regulation of the natural-gas industry to the informed judgment of the commission and not to the preferences of reviewing courts." The offset was representative of standard Commission refund procedures and the FERC had provided sufficient justification for changing from its original position of not using it. The Commission filed its own petition for rehearing in April 1985,

40 See "FERC's Btu-Adjustment/Production-Related-Cost Offset Scheme Drew Fire....," Inside F.E.R.C., January 7, 1985, pp. 8-9; and "Court Btu-Offset Reversal Another Knot in Big Tangle, Pipelines Say," Inside F.E.R.C., March 11, 1985, pp. 1, 4b-6. Reports filed by forty-three pipelines revealed that over $450 million had been offset after Order No. 399-A was issued. See "Commission Vacates Offset Mechanism for Payments Due for Btu Overcharges and Production Related Cost Recoveries," FERC Monitor, July 25, 1985, p. 2. An OPPR staff member involved mainly in producer regulation had stated in an interview, however, that the court order was not very disruptive because few producers and pipelines had used the procedure by the time that the court struck it down. The staff member felt that the Commission was aware that the offset might be overturned in court especially if the D.C. Circuit heard the case. This feeling was not strong enough to convince the commissioners not to approve the offset, however.
however in May the full D.C. Court denied the requests without comment.\footnote{See "As Expected, Rehearing of the Ruling on Btu-Adjustment Offsets...," \textit{Inside F.E.R.C.}, March 18, 1985, pp. 3-4; "An Appeals Court Wrongly Substituted Its Views for Those of FERC...," \textit{Inside F.E.R.C.}, March 25, 1985, p. 12; "The Commission Last Week Refused to Stay a Deadline for Btu Refunds...," \textit{Inside F.E.R.C.}, May 6, 1985, pp. 2-3; and "An Appeals Court Has Washed Its Hands of the Btu-Adjustment Issue," \textit{Inside F.E.R.C.}, May 20, 1985, p. 3. While this court action was occurring, three small producers had asked the FERC to stay a deadline of May 3, 1985, by which they were to collect their refunds. They noted the difficulties that they were having in collecting the amounts and also argued that the court order could lead to changes in the rule. A stay of the FERC deadline would avoid any administrative costs being incurred by pipelines and producers to implement a rule that might be changed. The FERC denied this request, saying that regardless of whether the offset procedure was reinstated on appeal or overturned the producers still had to pay by the deadline any Btu refunds that exceeded the production related costs owed to them. See "Refund Stay Sought," \textit{Inside F.E.R.C.}, April 15, 1985, p. 4b; and "The Commission Last Week Refused to Stay...," pp. 2-3.}

A group of twenty-two producers then appealed to the Supreme Court. The producers argued that the D.C. Court had treated the motion filed by AGD to force compliance as a petition to review the Commission’s Order No. 399-A. The producers contended as they had before the D.C. Court that this was improper procedure and that if allowed a party would not first have to file for and be denied rehearing by the agency before seeking judicial review. The AGD, along with the Process Gas Consumers Group and other industrial groups, argued that the Supreme Court should not grant \textit{certiorari}. In October, 1985, the Court decided not to hear the case.\footnote{See "Court Hears Ratable-Take Argument, Puts End to Btu-Offset Controversy," \textit{Inside F.E.R.C.}, October 14, 1985, p. 9. The decision not to grant \textit{certiorari} was reported as \textit{Pennzoil Co. et al. v. Associated Gas Distributors et al.} 474 U.S. 847 (1985). The Commission had (continued...)}
The litigation arising out of the offset mechanism continued to reflect the different industry segments vying with each other. However, the alignments had shifted somewhat as pipelines joined with the producers in the interest of stability. Producers and pipelines fought in the courts against distributors and industrial customers with the Commission almost a bystander. The producers and pipelines quickly filed for rehearing with the D.C. Court weeks before the Commission did. The producers took the case to the Supreme Court. The Commission, however, vacated the offset mechanism while the case was still on appeal to the Supreme Court. The prominent role of producers and pipelines reflected the reality that they were the parties that were going to have to implement the D.C. Court's decision. The Commission would have to issue an order and oversee the refund process, but pipelines and producers were the parties that actually had to complete the accounting and other transactions to insure that refunds were made.\(^{43}\)

There is some evidence regarding perceived penalties for non-compliance although the role of this variable in this case does not appear to be as crucial as that of the other variables. As mentioned above, during Commission discussions of refunds owed under the INGAA ruling staff from the General Counsel's office argued that producers would have to collect from royalty owners no matter how difficult.

\(^{42}\) (...continued)

 proceeded to vacate the offset mechanism by issuing Order No. 399-B in July 1985. At the end of October 1985, the Commission reported that thirty-five pipelines had received \$406.8\ million in Btu refunds from first sellers. Outstanding refunds totalled \$70.3\ million. The pipelines had offset about \$494\ million in Btu refunds against production related costs owed to producers before the FERC vacated the order. See "Refunds Tallied," *Inside F.E.R.C.*, November 18, 1985, p. 9.

\(^{43}\) A member of the FERC at the time stated that the Commission was not as interested in the case as the industry was.
Otherwise, the rule would be overturned by an appeals court. The opposition of Commissioners O’Connor and Sousa to the use of the offset mechanism might have been based partly on perceived penalties although the need to obey the legitimate authority of the court appears to be the more important motivation for them.

An OPPR staff member said that the FERC was not concerned about the prospect of further litigation especially over the issue of whether refunds had to be ordered. The Commission felt that refunds were required, but there was some concern over how the refund policy would be handled in instances where refunds might create hardship for some producers. The FERC wanted to develop a "generous" schedule to avoid or minimize damage to the extent possible but even in those cases refunds were to be made. The staff member noted that there was some feeling at the FERC that it was being watched as it responded to the INGAA ruling. If the Commission had not ordered refunds, then further litigation seemed very likely.44

The findings presented in this section provide some support for the hypotheses discussed in Chapter 1. High commitment by the FERC to the dry rule is important in explaining less enthusiastic implementation of the first INGAA decision. However, the Commission reinstated the wet rule fairly rapidly and did order refunds. As in Mid-La, the positive view of the court as legitimate authority to be obeyed (rather than as mere political friend or foe) was overwhelming. If the duty to obey the law and insure that proper prices were paid was the core of commitment in this case, that also meant the duty to obey the law as interpreted by the

44 But the FERC also felt that it had no discretion on the refund question so that, according to the staff member, there was "very little thought that you could possibly be doing anything that the people that took you to court in the first place would have to take you back."

303
legitimate interpreters. Thus, positive view of the court helped result in more faithful implementation.

Disruptiveness clashed both with the commitment to a refund policy and with the positive view of the court (duty to obey the legitimate authority of the court). The need felt by some of the commissioners to consider disruption resulted in the offset mechanism which might be seen as an attempt to pull back from or avoid the full impact of the first INGAA ruling. Greater disruptiveness thus did lead to attempts to avoid or evade the ruling (through the offset and through the appeals process) as hypothesized. It took a second court ruling to push the FERC to lay aside concerns of disruptiveness and proceed with implementation.

External pressures were considerable here both for and against implementation of the first INGAA ruling and were quite significant at some stages of the case such as the debates over refunds and offsets. Both hypotheses relating to external pressure and implementation appear to be supported as pressures both aided (follow-up litigation leading to INGAA II) and impeded (group efforts to implement offsets) implementation. In a sense then, the pressures cancelled each other out as the different industry segments fought each other (more so than the FERC) in court and attempted to shape the Commission's agenda. The case does show how groups can use litigation to influence agency policy (wet vs. dry rule; refunds vs. offsets) and subsystem operations (refunds vs. offsets; conflict over smooth operations) particularly when large amounts of valued resources or revenues are at stake.

The final independent variable, perceived penalties for noncompliance, was present in a more minor role than the other variables. It

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45 Greater pressure in support of an order should lead to more faithful implementation. Greater pressure in opposition to the order should lead to less faithful implementation.
appears to be a contributing factor to Commission debates in a couple of instances and is in the hypothesized direction although the evidence cannot really be considered overwhelming. The Commission felt the need to comply with the court orders by requiring refunds and vacating the offset but other factors such as positive view of the court (duty to obey) may have been more determinative. As in *Mid-La*, the FERC felt that it had little discretion.

There was an interesting comment by the FERC in this case that provides further evidence that litigation may not be the penalty originally thought. The Commission remarked that it wanted to ensure that parties had the opportunity to seek review of a final rule in this case. As shown above in Chapter 2, the role of the courts in natural gas regulation is established by both of the major statutes administered by the FERC. Data compiled by the Commission showed that it was actively engaged in litigation and an assistant to one of the commissioners is quoted in that chapter to the effect that FERC orders are not final until the courts had ruled on them. Thus it might not be entirely surprising that judicial review and the litigation leading up to it (and perhaps the risk of defeat in court) would appear to be established parts of subsystem operations.

Some observations can be made with respect to the secondary hypotheses. As already shown and contrary to expectations, agency commitment did not override disruptiveness (redefined as disruptiveness to industry) in shaping agency response to the court. External pressures did have some impact on commitment during the rulemaking process and in shaping agency response to the court as a pro-producer Commissioner was able to secure approval of the offsets. Agency view of the court was influential here as in *Mid-La* and was not overwhelmed by agency commitment.

As mentioned at the beginning of this section on the *INGAA* case, the Commission's response to the court order was mixed and included
both implementation and evasion. This varied response was due to the mixed motivations that compelled the FERC to act in certain ways. Practically all of the independent variables are major influential factors here, conflicting with each other in some instances. Ultimately, however, obedience to the court as a legitimate authority appears to have been the dominant factor.

The Maryland People's Counsel Case

The Commission's response to the court in *Maryland People's Counsel* is described in Chapter 3 as implementation limited somewhat by caution and/or evasion while the response in the follow-up *Associated Gas Distributors* is classified as implementation. As discussed below, the FERC response in *MPC/AGD* is characterized by limited agency commitment to its initial programs as the Commission moved to develop a new transportation policy followed by variable commitment to that new policy; major external pressure in the form of the various industry segments and other outsiders (in Congress and elsewhere) trying to influence the FERC as its policies evolved; increasing importance of disruptiveness as the Commission's policy and response to the court continued to progress and the consequences were felt; positive view of the court once again as an authority to be obeyed and as an aide in policy development; and low perceived penalties for noncompliance as the Commission believed that it was complying with the court's mandate.

The limited agency commitment is discussed first. There are some indications that commitment of the FERC to its pre-*Maryland People's Counsel* blanket certificate and special marketing programs was in fact limited. As the Commission proceeded in the early 1980s with the implementation of those early programs, it was considering various
ideas to cope with the problems of a gas surplus, high prices mandated by contracts, and the inability of gas to reach some markets and customers. Assuring access by those seeking to ship gas (such as producers selling directly to customers) to the interstate pipeline network and providing incentives to pipelines to transport such customer-owned gas were becoming increasingly important issues.

The Commission’s policies were in a state of flux at this time as it experimented with the blanket certificate and special marketing programs. An important point here is that these were experiments and thus the FERC was committed to them mainly as interim measures. As is shown below, the FERC was not always sure that it was doing the right thing. By late 1984, however, the Commission had embarked on the course that would lead to Order No. 436 and, it was hoped, open access to transportation.

A former senior official of the Office of Pipeline and Producer Regulation observed that the price of gas was rising despite discount rate programs approved by the FERC. These price increases were thwarting the NGPA purpose of market responsive prices. Customers with the capability were switching from gas to alternate fuels." It was in this

46 An official of the Office of Pipeline and Producer Regulation noted in mid-1983 that gas loads were down by twenty percent as customers switched to oil. An official of the American Gas Association, a group with pipeline and distributor members, estimated that sixty to seventy percent of industry had the ability to switch fuels. See "The Many-Splendid Uses of Natural Gas Imperiled by Rising Prices," *FERC Monitor*, July 11, 1983, p. 1.

By the middle of 1984, this situation had changed somewhat as the Commission’s Office of Regulatory Analysis found that competition from other fuels had diminished. The emphasis then shifted to competition among different suppliers of gas (gas on gas competition). Subsequent FERC policy fit into this pattern, including the special marketing programs and Order No. 436 which would enable customers to choose among

(continued...)
atmosphere that the FERC had approved the Northern Natural rates discussed in Chapter 3 and in the next section. The Commission then proceeded to approve the special marketing programs which were an attempt to initiate a spot market for gas. The official also observed that the FERC realized that it was "pushing the outer limits" of the law with the SMPs and did not grant permanent certificates for those programs. The Commission, however, was trying to transform the industry.\footnote{308}(...continued)


\footnote{47 In the words of an official with the OPPR, the problem in the early 1980s was the "gas bubble." Inexpensive gas was shut in and not being taken by the pipelines who were faced with ever larger take-or-pay obligations. Pipelines were taking more expensive gas to meet their contractual obligations while the inexpensive gas was left in the ground. The Commission had to develop policies and methods by which gas could "seek its market and not be shut in." Ultimately that would lead to Order No. 436.

Describing the gas market's situation at this time, a member of the FERC during the Reagan administration stated that the pipelines had signed contracts with producers in the late 1970s and the early 1980s that had "grossly misforecasted" the price of and the demand for gas. The pipelines faced large take-or-pay obligations in those agreements and it was beginning to appear as if they would never be able to catch up even though contract terms allowed them up to five years to take the gas for which they had paid. The recession in the early 1980s and the collapse of OPEC aggravated these "gross mistakes" that the pipelines had made. Pipelines and local distributors also began to lose residential customers.

The pipelines responded to these problems by attempting to discriminate in favor of the industrial customers with the approval of the Commission. They then developed the special marketing programs, a discriminatory approach that the commissioner thought was sensible given the context within which the FERC was working. The Commission did not believe that it could order pipelines to transport gas. It could merely permit pipelines to do certain things.}
One indication of the Commission experimenting and not being entirely certain of how to proceed is the divergence of views among the Commissioners. For example, division was evident in July 1983 when the FERC issued Order No. 319, a blanket certificate rule allowing pipelines to keep some of the revenues that they might earn from transportation of gas for others. The policy of providing incentives for pipelines to transport gas was opposed by Commission Chair C. M. Butler III who dissented from the rule, unhappy that "this commission needs to bribe pipelines to do what they ought to be doing anyway." Butler felt that the Commission needed to force the pipelines to accept more risk by requiring them to transport a projected volume of gas in order to make a profit.

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48 See Sales and Transportation by Interstate Pipelines and Distributors; Expansion of Categories of Activities Authorized under Blanket Certificate; Final Rule; Docket No. RM81-29-000; Order No. 319; Issued July 20, 1983, 48 Fed. Reg. 34,875 (August 1, 1983). The rule contained three types of incentives. First, pipelines could establish rates for transportation based on representative volumes or revenues (set for a test period as part of a regular rate case) and keep any revenues to the extent that the actual realized revenues and volumes fell within the representative range. Second, pipelines choosing not to include transportation rates and volumes in test period rates could keep 1 cent per million Btu or all revenue earned in excess of the cost of providing the service. Third, pipelines choosing not to include transportation rates and volumes in test period rates could charge transportation customers an Additional Incentive Charge (AIC) of up to 5 cents per million Btu. The AIC was to be an experiment for eighteen months. The Commission noted that pipelines had not participated on a large scale in its transportation program up to that point and that "although it is not certain that a financial incentive would greatly encourage transportation to end users, it is a reasonable assumption." See Order No. 319, 48 Fed. Reg. at pp. 34,880-34,881.

49 Butler made this proposal about three months before leaving the Commission. He had already announced his plans to leave and one staff member felt that his lame duck status made the other Commissioners less willing to listen to his ideas. While Commissioners Richard and Hughes (continued...)
It was in this atmosphere of uncertainty and groping for solutions in mid-1983 (taking "baby steps" in policy development as one former commissioner stated) that the Commission began to consider various new marketing programs proposed by pipelines and producers. It was also

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There was also divergence between commissioners and staff. For example, at a Commission meeting in early 1983, Kenneth Williams, the Director of the Office of Pipeline and Producer Regulation and thus a high ranking staff member, opposed a proposal to give pipelines an incentive to transport gas for others. This incentive was to allow pipelines to add an extra charge (1 cent per million Btu) to such gas. However, soon thereafter at a conference of gas industry officials, Commissioner David Hughes stated that the FERC might be willing to allow pipelines to keep some of the revenues earned from transporting customer-owned gas under the blanket certificate program. Hughes noted that pipelines felt that the 1 cent per million Btu charge was an insufficient incentive while the OPPR believed that no incentive was needed. See "FERC May Allow Pipelines to Keep Excess Transportation Revenues for Themselves....," *Inside F.E.R.C.*, May 9, 1983, p. 3.

50 For example in late July 1983, the producer Tenneco Oil applied for FERC approval of a plan (named TENNEFLEX) whereby it would sell gas to bidders each month. The differing reactions of staff and the Commissioners to the proposal illustrate the point made above about divisions at the FERC over how to respond to market conditions. Kenneth Williams's reaction to the proposal was cautious, as he told the Commissioners that Tenneco had to be more specific about what markets it wanted to serve and how it would actually implement the proposal. The Commissioners, however, wanted to move ahead more quickly with the plan. They said that they did not want the proposal to be held up in hearings and decided to hold an informal public conference in August. See "Commission Sets Conference on Tenneco's Spot Market, Hearing on Panmark," *Inside F.E.R.C.*, August 1, 1983, pp. 1-2. At a meeting of the FERC in September after the conference had been held, staff suggested that the Commission conduct hearings on Tenneco's proposal.

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at this time that Columbia Gas began the sequence of events that would lead to its special marketing program and eventually to the *Maryland People's Counsel* litigation.

As described in Chapter 3 Columbia had applied to the Commission for authority to transport gas that it been unable to sell from Exxon, its largest supplier, to customers willing to purchase the gas. The Maryland People's Counsel protested this plan, claiming that it would allow Columbia to separate its customers into different markets. The pipeline could continue to charge high noncompetitive prices to its captive customers. There would be no pressure to lower prices because there would be no fuel switching by Columbia's large industrial customers. After the FERC had modified and then approved Columbia's plan, the MPC and the Process Gas Consumers Group continued to attack the exclusion of core customers. Both parties made similar claims that the plan was anticompetitive and discriminatory.

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Both Kenneth Williams and the acting General Counsel suggested that the Commission be very careful in approving the new arrangement. Two of the Commissioners, Oliver Richard and Georgiana Sheldon, reacted angrily to the suggestion of going slowly by holding hearings. Staff was directed to prepare an evaluation of the Tenneco plan instead. See "Commissioners Balk at Tenneflex Hearing, Want to Handle Case Themselves," *Inside F.E.R.C.*, September 19, 1983, p. 3.

See "Columbia Plan to Move Gas from Exxon to End-Users Called Discriminatory," *Inside F.E.R.C.*, August 29, 1983, p. 8. Deciding which markets to include in the SMPs was, in the words of an official from the Office of General Counsel, "one of the most difficult questions the Commission grappled with...." See "Incentive Sales Programs: Will They Work?" *FERC Monitor*, November 17, 1983, pp. 1, 7.

See "FERC Allows Transco to Continue Carriage Deals, Lays Plans to Refine ISPs," *Inside F.E.R.C.*, December 19, 1983, pp. 1, 7-9. Some at the Commission agreed with these sentiments. For example, an aide to Commissioner Sousa remarked in an interview that the Commission was (continued...)
Even though the FERC had embarked on the SMP policy, its members were not entirely satisfied with that approach. Doubts about the wisdom or the functioning of the SMPs were expressed by most of the Commissioners at a meeting in March 1984. For example, Commissioners Richard and Hughes were concerned that the programs were not a sufficient answer to the problems of take-or-pay contract provisions. Commissioner Sheldon was afraid that the FERC may not have done "the greatest favor to humanity" by approving the programs.

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Trying to prevent competition at this time up to the Maryland People's Counsel decision. In the words of the aide, "we restricted access to transportation, we restricted access to gas supplies" even after the NGPA had given local distributors access to interstate pipeline facilities.

A member of the FERC at the time stated that the special marketing programs were meant to be a "band-aid" as the Commission was working on its new framework. Another indication of the FERC experimenting and of limited commitment to its programs was a notice of inquiry on the impact of the special marketing programs (SMP), issued by the Commission in January 1984. While the Commissioners stated that they were concerned about the discriminatory nature of the programs, other parties responded with scepticism or with a wide variety of solutions to the marketing problems facing the industry. The sceptical responses were from some of the parties who had accused the FERC of being discriminatory. One such party felt that the Commission was going to undertake "decades of research" before resolving the problems. Another believed that the FERC was issuing the notice as part of a defensive strategy. The Commission could then tell the courts in any legal challenge to the SMPs that it was considering their discriminatory and anticompetitive aspects while not really doing anything to change them. See "NOI Explores Possibility of Greater Competition to Bring Down Gas Prices," Inside F.E.R.C., January 23, 1984, pp. 1, 4-5. It should be noted that the Maryland People's Counsel began its legal challenge to the Columbia plan and blanket certificate orders at about this time.

Soon after expressing these views about the special marketing programs, the Commissioners approved stringent reporting requirements to monitor them on the basis that the information provided by participants had not been sufficient for staff to trace transactions from supplier to end user. Proponents of the SMPs were upset by the requirements and some felt that the Commission and staff were trying to kill the programs.

(...continued)

was especially concerned about the wisdom of special marketing programs. At a seminar sponsored by the American Gas Association in April 1984, she said that she was "struggling today more than ever before" to determine whether the Commission’s actions were hindering the market. She expressed disappointment that the industry had not devised other initiatives to deal with market conditions and she also stated that "the Commission should never be in the business of rubber-stamping industry’s answers for correcting the market." See "Sheldon Questions Generic Regulation of Special Gas Marketing Programs," *Inside F.E.R.C.*, April 30, 1984, pp. 1, 4.

Also reflecting the mentality that the FERC was not entirely wedded to the SMPs as a permanent solution were the views expressed by Chair O’Connor in an interview in early 1984, soon after he came to the Commission. O’Connor stated that there were no apparent easy solutions to the problems of the gas market and that he was committed "to reviewing an array of options" to assist the industry and the public. He stressed the importance of predictability and the need to avoid actions that might make matters worse. See "Chairman O’Connor’s Biggest Challenge: Management," *FERC Monitor*, February 9, 1984, pp. 1-2.

Charles Stalon, who joined the FERC in 1984, observed that in that particular year the Commission was becoming increasingly aware of the shortcomings of the transportation policies that it had approved. He wrote that "it became increasingly obvious that the gas industry was not being moved towards efficient outcomes by the discriminatory programs" such as Order No. 234-B and the SMPs that had been "embraced by pipelines and accepted by the Commission." More discrimination appeared "futile, [citation omitted] justifiable only to buy time until an alternate program could be created." See Charles G. Stalon, "Pipeline Open Access and the Deregulation of Natural Gas Production," Paper presented at the American Enterprise Institute Conference on Policy Approaches to the Deregulation of Network Industries, Washington, D.C., October 10-11, 1990, pp. 9-10.

313
OPPR Director Kenneth Williams responded that the Commission needed the data to monitor and justify the programs. Williams said that the FERC had taken a risk in approving the SMPs without a hearing and that the courts would not affirm the FERC if it did not oversee them.\(^5\)

While the FERC was proceeding at times half-heartedly with the special marketing programs, other steps were being taken that would have some impact on the subsequent policy actions that the Commission pursued. In mid-1984 FERC Chair Raymond O'Connor had hired a new Director for the Commission's Office of Regulatory Analysis (ORA), Charles Teclaw. Teclaw proceeded to give the Office, which performed economic policy analyses and monitored market activities, a more active profile. His vision of the Commission's future included "the growing

\(^5\) See "Tough New Requirements Slapped on Reporting of Spot-Sales Transactions," *Inside F.E.R.C.*, April 2, 1984, pp. 1, 4-4a; "Williams: Marketing Programs Can't Exist Without Reporting Requirements," *Inside F.E.R.C.*, April 9, 1984, pp. 1, 5-6; and "Reporting Requirements Expanded for Gas Special Marketing Programs," *FERC Monitor*, April 19, 1984, pp. 1, 5, 8. Williams also said that the main use of the data would be to allow the opponents of the programs "to determine exactly what's happening and whether or not what the Commission said in its support of the program continues to support the program." In a concurring statement, Commissioner Richard argued that the limited experiments of the SMPs were necessary for the FERC to collect the data that it needed to determine its future regulation of gas transportation. The reports were needed because "information is essential. How else are we to know?" See "Reporting Requirements Expanded," p. 8.

The FERC denied rehearing and affirmed the reporting requirements in June 1984, stating again that data were needed to monitor the SMPs. The Commissioners said that they would consider claims of harm on a case-by-case basis. Chair Raymond O'Connor said, however, that the reporting may be "a hollow exercise" because of distributors' opposition. See "FERC Stands Firm Behind SMP Reporting but Offers Open Ear for Complaints," *Inside F.E.R.C.*, June 18, 1984, pp. 1, 5; see also "Commission Denies Rehearing of Reporting Requirements for Special Marketing Programs," *FERC Monitor*, July 12, 1984, pp. 1, 9.
importance of using competition" as an instrument of regulation. The importance of Teclaw's hiring is that he was an important participant in the rulemaking process resulting in Order No. 436 and is another indicator that the FERC under O'Connor was planning to move beyond the programs targeted in the MPC litigation.

In September 1984, the Commission extended the SMPs for an additional year and acted on a number of concerns that had been raised. A major action taken by the FERC in this order was its attempt to deal with the charge of discrimination by allowing firm customers of pipelines


57 A former assistant to FERC Chair O'Connor referred to Teclaw as the "intellectual godfather" of Order No. 436. A former senior official of the Office of Regulatory Analysis noted that the Office had become bogged down in the analysis of individual cases and orders that came before the FERC. Under Teclaw, the staff started to work on the broader picture and the first result consisted of the notices of inquiry in the Order No. 436 rulemaking. The questions and issues raised in the notices of inquiry were "preparatory" for Order No. 436 as the "basic ideas of 436 were in our minds at that time." In the FERC Monitor interview cited above, Teclaw had not been specific about the strategies for increasing competition that he and the ORA intended to pursue. He stated that the Office was "in the process of reviewing where we are and what our agenda should be." This was in mid-1984 when the Office probably would have been working on the notices of inquiry that were the beginning of the Order No. 436 process. See "Teclaw of ORA," p. 1.

In a conference paper written several years after these events, Charles Stalon, who joined the FERC in 1984, stated that during that particular year "the conviction came to be widely accepted that the then-existing role of ... pipelines was not sustainable and that substantial changes were necessary." See Stalon, "Pipeline Open Access," p. 4. Pipelines would have to offer more transportation, separate from sales or other services (unbundled), and such service would have to be less discriminatory. Another part of this consensus view was that the FERC would have to lead the industry restructuring.
such as local distributors to participate. These customers could purchase up to ten percent of their contracted volumes under their pipelines' SMPs. The Commission also eased the reporting requirements that had been opposed so forcefully by distributors. The order was felt to be an affirmation by the FERC of the SMP policy. It is probably more accurate to say that this order was fine tuning (an attempt to correct the flaw of discrimination) and an extension, but the policy was still an interim measure.

58 While aware of the fact that they had not had hearings on the SMPs when originally approving them, the Commissioners still did not want to hold hearings on the programs when extending them because they would have to be suspended during the course of the proceedings. See "FERC Widens Competitive Field as It Extends SMPs for Another Year," Inside F.E.R.C., October 1, 1984, pp. 1, 4-6; and "Special Marketing Programs Continue," FERC Monitor, October 18, 1984, pp. 7-8. Kenneth Williams reported that staff review of data submitted in monthly reports, and review of comments submitted in the notice of inquiry and at the public conference the previous August led it to conclude that "the SMPs have been working pretty much... consistent with the contemplations of the Commission when the SMPs were previously authorized." While the Commission had approved twelve programs by this time, only three had operated long enough to provide any data on their impact. Williams reported that the three pipeline programs had reduced those pipelines' take-or-pay liability by over $500 million dollars. He also stated that limiting the programs to marginal markets had been a success as gas consumption had increased.

59 The attempt by the FERC to make the programs less discriminatory did not satisfy such critics as the Maryland People's Counsel and the Process Gas Consumers Group. The MPC stated that the 10 percent allowance "falls 90% short of the regulatory goal of stimulating competitive price reductions" for distributors' general system supply. The PGC said that the Commission had thrown "the distributors a bone in the form of possible savings on very limited volumes" but that the order would prevent the market from lowering prices on a larger basis. Columbia Gas, however, stated that the 10 percent allowance would cause it to lose sales and raise prices for captive customers. See "Higher Transportation, Sales Rates Seen Possible Results of SMP Order," Inside F.E.R.C., (continued...)
By the end of 1984, the Commission was prepared to embark on the course that would lead to Order No. 436. The Commission issued notices of inquiry in December 1984 and January 1985. Chair O'Connor said in December 1984 that the FERC had actively encouraged gas transportation but that "even greater improvements" were possible in the Commission's regulations. The FERC would try to develop a "consistent and evenhanded policy on the pricing of pipeline transportation services" and the allocation of costs among customers. O'Connor sought the "active and constructive participation of all parties affected by the commission's natural gas jurisdiction" in furthering the goal of greater competition without discrimination or other abuses of market power.60

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November 5, 1984, pp. 1, 5-6. A member of the FERC at the time commented in an interview that the pipelines "generally subverted" this provision so that it had limited effect.

60 See "FERC Inquiry to Look at 'Big Picture' of Transportation, Rates, Risks," Inside F.E.R.C., December 24, 1984, pp. 1, 4-5. O'Connor also noted that the Commission had approved a "patchwork" of transportation programs and tariffs. The FERC would have to decide whether a single standardized program would work better or special programs customized for each pipeline or producer or customer. The Chair declared that "it is a matter of national priority for prices in the gas industry to be responsive to competition." And he stated that "questions that once were thought routine now must be considered within a broader context of competition and market forces." O'Connor's remarks were reprinted in the Public Utilities Fortnightly. See Raymond J. O'Connor, "Balancing Competition and Regulation in the Natural Gas Industry," Public Utilities Fortnightly, January 24, 1985, pp. 15-17. Stalon thought that the Commissioners had several main objectives at this time: first, end the "grossly inefficient performance of the industry" and possibly improve efficiency; second, free pipelines from their take-or-pay difficulties without bankrupting them; third, use increasing competition to improve the efficiency of the industry; and fourth, use increased transportation services to increase competition. Stalon observed that there was not a consensus among the Commissioners on how to resolve the take-or-pay problem. See Stalon, "Pipeline Open Access," p. 16.
The development of the proposed rule was entirely internal to the FERC involving coordination among various offices. The proposal did not become public until it was released by the Commission in May 1985. The FERC received much advice during the course of the rule-making and in response to the MPC decisions, however a former ORA official stated that many items in the rule had originated with that office. The Commission knew what it wanted to do and wanted

61 The former ORA official observed that Raymond O’Connor was criticized for being secretive but O’Connor knew that once his intentions became public it would become difficult to accomplish those goals because the opposition would muster. Because someone would oppose everything that the Commission attempted, the opposition could kill O’Connor’s plans before they "hit the street." This possibility led O’Connor to be secretive about the development of Order No. 436 but once the rule became public the opposition had to respond "substantively" instead of "politically" and it was harder for them.

The former ORA official did not know of any involvement by the White House or the Department of Energy (DOE) in the Order No. 436 rulemaking. He said that "if there was any involvement, it was not at my level." Chair O’Connor did not believe that the Department of Energy should be trying to influence the FERC through "the back door of the policy office." Some DOE staff had offered to work with ORA but the ORA staff had declined the offer. O’Connor sought to maintain the independence of the FERC and felt that the DOE could communicate with the FERC by filing comments. The Department had filed comments, but the official stated that "we paid no attention to them by and large." The DOE, however, "believes that they wrote Order 436."

62 By May of 1985, the staff of ORA had completed a major policy analysis of the gas industry. A former senior official of the Office characterized this document as "the analytical and intellectual foundation" of Order No. 436. Order No. 436 was "fully conceptualized" before the Maryland People's Counsel decisions even though the proposed rule was issued after the court orders. Thus, the official noted that "there’s a sense in which 436 was a response to the [MPC] decision ... but there’s a much more important sense in which this [Order No. 436] really went on course independently of that decision."

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reaction to those ideas but "what we didn’t do is provide the whole context." The official thought that the FERC should have released the accompanying policy analyses done by the Office so that outside parties would have had a better idea of how the FERC thought that its ideas would work.63

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The Commission never denied that Order No. 436 was the direct result of the Maryland People’s Counsel decisions although the former ORA official said that it was not. He noted that much of the work on the rule had been completed prior to the court decisions, stating that "we were really ready to go on this [Order No. 436] well before that decision came out." However, the court orders may have resulted in Order No. 436 being approved by the Commission "more expeditiously" than it otherwise would have been. The speed of the rulemaking was "remarkable" and had resulted in some of the most "dramatic changes" that had ever come from the Commission.

A member of the FERC at this time agreed with the sentiment that the MPC rulings were not the prime motivating factor in the Order No. 436 rulemaking although they did have some impact. The former commissioner stated that the NGPA deadline of January 1, 1985 when some natural gas production was deregulated was the major motivation.

63 A member of the FERC at the time stated that the internal rulemaking process for Order No. 436 had avoided the staff and their biases. The rulemaking had been "largely taken away from ... the downstairs staff." These staff members, lawyers, engineers, and operations and implementation staff, had been "largely pushed out of the process." However, OPPR director Kenneth Williams and some of his top assistants had been included in the group formulating Order No. 436 because their office would be responsible for implementing the rule. The Commissioner noted that "we weren’t going to go forward with this unless they thought they could implement it." Williams was an "exceptional man" who was highly respected within the FERC and who understood what the rulemaking was trying to achieve.

An assistant to Chair O’Connor, who was involved in drafting Order No. 436, observed that many of the line staff in OPPR and the General Counsel offices did not become aware of the rulemaking until the proposed rule was about to be issued. He felt that that was one of the weaknesses of the effort.
At the same time that the FERC was developing its new framework and receiving large amounts of conflicting advice on how to proceed with that development, it was doing battle with the Maryland People's Counsel in the D.C. Court of Appeals. The Commission challenged the standing of the MPC to bring its case to court and denied the Counsel's motion to stay the special marketing program orders pending the outcome of the court case. 64

These defensive actions might seem to contradict the Commissioners' stated misgivings about SMPs and their intentions to move on to a new policy. The FERC, it should be noted, did not feel that the special marketing programs had been a failure but rather that they were successful as far as they went. The Commission's commitment was limited but the FERC was still committed. In his speech, FERC Chair O'Connor noted that these programs and the blanket certificates had resulted in gas being moved and prices being reduced. In addition, the Commission had claimed in a letter to the Chair and Ranking Minority Member of the House Energy and Commerce Committee that the SMPs had helped to bring gas wellhead prices down by sending price signals from customers to producers. 65

However, the Commission wanted the transition to its new policy to be as orderly as possible. In addition to defending the special marketing programs in court and to the Congress, the FERC proposed an extension of the blanket certificate program until December 31, 1985 while it

64 See "Court Appeal of FERC's Original SMP Order Hinges on Issue of Standing," Inside F.E.R.C., March 4, 1985, pp. 11-12; see also "As Expected, the Commission Has Refused to Stay its SMPs....," Inside F.E.R.C., March 11, 1985, pp. 4a-4b.

continued its inquiry into new policies. As shown below and in the discussion of the Btu measurement case, the Commission generally does not want its policies to be too disruptive of the industry and/or threaten the continued delivery of gas to customers.

Thus, the Commission's approach during the first half of 1985 was cautious, maintaining existing programs while formulating a new policy that would present some major changes to the gas industry. In the words of a former senior official of OPPR, the Commission "knew where it was going, knew that they were eventually going to have to deal with the discrimination and had already laid the groundwork as to how they were going to do that." The Commission knew that it had a limited amount of time to complete the transition that it had undertaken. As a member of the FERC at this time stated, there was a realization at the Commission that the agency could lose the battle in court.

External pressures came into play more prominently after the Commission issuing the notice of proposed rulemaking for Order No. 436 on May 30, 1985. As described more fully in Chapter 3, the proposed rule consisted of four parts: nondiscriminatory transportation, take-or-pay payments, optional expedited certificates for new service, and a three

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67 An assistant to Chair O'Connor who attended the oral argument of the MPC cases (about three and one-half months before the decision) stated in an interview that he left the courthouse convinced that the FERC would lose. The Commission had to be ready for that possibility and Teclaw and the ORA thus intensified their efforts.

part block billing mechanism for gas. As this study is concerned with the Commission's implementation of the Maryland People's Counsel decisions, the transportation provisions are the most important for the examination in this chapter. The industry and congressional reactions to the block billing mechanism and the Commission's response are treated somewhat below also because of their potential impact on the transportation provisions and thus on the Commission's response to the Maryland People's Counsel decisions.\(^{69}\)

\(^{69}\) A brief summary of the block billing proposal of the NOPR and the request for additional comments issued along with Order No. 436 would be helpful at this point. The Commission believed that the system of rolled in pricing, which had been used by pipelines for some time, did not allow proper price signals to be sent from customers to gas producers. Under rolled in pricing a pipeline could purchase expensive (usually unregulated) gas and then average its cost with any inexpensive gas (usually NGPA regulated or "old" gas) that it also had purchased. Customers would be charged a price lower than that which the pipeline was paying some producers while producers of the more expensive gas, believing that their product was marketable at the higher price, would have no incentive to lower the price that they charged. In addition pipelines had differing amounts of inexpensive gas under contract. Those with more of the cheaper fuel had a great advantage over the other pipelines, merchants, and brokers who were also trying to sell gas but who were not blessed with as much (or any) of the inexpensive supplies. The Commission saw this as an unlevel playing field.

In the proposed rule, the FERC suggested replacing rolled in pricing with a three part block billing mechanism. The first block would contain the inexpensive (NGPA "old") gas and would be reserved for a pipeline's current firm sales customers while the second block would contain all other, more expensive, gas. The third block would include the nongas costs associated with purchasing gas. While current customers would still receive the benefits of the inexpensive gas, "the effective use of old gas as a competitive tool in marginal or new markets will be blunted." New supplies would be separated into the second block and customers would thus base their decisions to buy on current costs. Differences between the market price and a pipeline's second block price "would impose market discipline on the pipeline in the form of load loss." The sale of second block gas would be a judgment by customers on the (continued...)
The Commission's proposed rule was greeted with various reactions from the industry segments and gas customers. Both House and Senate appropriations of a pipeline's gas acquisition. Unlike the other provisions of the rule, block billing would be mandatory and not voluntary.

As shown below, this proposal was met with significant opposition from many sectors. The fact that it was not a voluntary provision might have added to the opposition that it sparked. Producers and their representatives such as Senator Nickles of Oklahoma were especially concerned and upset, claiming that exploration and production would have been decimated. As Commissioner Stalon later wrote, block billing would have created pressure on pipelines and producers to lower the price of the second block gas. A pipeline's inability to sell such gas would have allowed it to use its contract rights to lower prices. Producers of high cost gas thus opposed the proposal. Producers of low-cost gas also opposed it because it would have eliminated any opportunity to raise the price of such gas to market levels.

In the face of this rather intense opposition, the Commission decided to revise the proposal and solicit additional comments instead of issuing it as part of Order No. 436. The Commissioners noted some of the adverse consequences that commenters claimed would result from block billing. They stated that "these are assertions that the Commission must and does take most seriously. The Commission has determined that these assertions should be carefully evaluated." The revisions included deletion of the third block and inclusion of such costs in blocks 1 and 2. The Commission also lengthened the time period used for calculating a firm customer's share of block 1 gas. The Commission had not implemented block billing by the end of the Reagan administration.

For the original proposal, see Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket No. RM85-1-000 (Parts A-D); Notice of Proposed Rulemaking; Issued May 30, 1985, 50 Fed. Reg. 24,130 (June 7, 1985) at pp. 24,138-24,139. For Stalon's comments, see Stalon, "Pipeline Open Access," pp. 23-24. For the revised proposal and request for additional comments, see Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket No. RM85-1-000 (Part D); Proposed Rule and Notice Requesting Supplemental Comments; Issued October 9, 1985, 50 Fed. Reg. 42,372 (October 18, 1985) at pp. 42,373 and 42,385-42,387.

A member of the FERC at the time noted that "one of the real shocks" was that many people did not take seriously the notices of inquiry (continued...
Energy committees held hearings at which industry representatives testified. FERC Chair O'Connor and the other commissioners also testified at both the House and Senate hearings, trying to explain and to build support for the new rule. The mere fact that the Commission felt it necessary to appear at such hearings is very important. As shown in Chapter 2, Congress had been unsuccessful in its attempts throughout the 1980s to approve major natural gas legislation. Congress probably could not approve legislation either stopping the FERC from issuing Order No. 436 or encouraging it to do so. Still, the FERC considered the House and Senate Energy Committees important enough forces in the natural gas policy subsystem that it wanted to explain the new rule to those legislators and hopefully convince them of its value.

At a hearing on June 27, 1985 of the Subcommittee on Fossil and Synthetic Fuels of the House Energy and Commerce Committee, Raymond O'Connor said that his agency "is committed to being fully responsive to you and other leaders in Congress in your oversight of the authority Congress has delegated" to the Commission in the Natural Gas Act and the Natural Gas Policy Act. O'Connor said that he was "proud that the entire Commission and its staff have been united over the last year" in meeting the goal of securing the benefits of competition for consumers. The new natural gas rule was "intended to be a comprehensive, integrated approach."

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at the beginning of the Order No. 436 process. The Commissioner was informed by an acquaintance that the FERC had apparently obtained a reputation among some parties in the industry of not acting on its inquiries and had lost some credibility. Producers, for example, were not active participants initially.


324
In the course of answering questions from the subcommittee members, O'Connor noted that producers had claimed during the inquiry phase of the rulemaking that their biggest problem was not being able to have gas transported nondiscriminatorily. Pipelines, on the other hand, argued that transporting gas would displace gas that they sold (sales gas) and aggravate their take-or-pay problems with producers. The Commission reviewed these comments and attempted to produce a rule that "if you added up the minuses and pluses, the pluses would come up ahead."

The various industry interests testified before the subcommittee in November 1985 after Order No. 436 had been issued. The views of some of the major groups are summarized here to show the diversity of interests and pressures on the FERC. The president of the Natural Gas Supply Association (NGSA), representing producers, expressed strong support for the nondiscriminatory transportation provisions of the rule. The group very strongly opposed the block billing mechanism, claiming that exploration and production of new supplies would be harmed.

\(^{71}\)(...continued)

*Subcommittee on Fossil and Synthetic Fuels*, 99th Cong., 1st sess., 1985, pp. 7-8, 11.

\(^{72}\) Ibid., p. 49. An assistant to Chair O'Connor observed that the effort was made to include in Order No. 436 provisions that could be supported by both producers and consumers and thus give them a common interest. Traditionally, one needed at least two of the three segments of the industry (producers, pipelines, or consumers) to support something in order to proceed. This is what the drafters of Order No. 436 tried to do. The effort to provide take-or-pay relief for the pipelines had been met with opposition by all parties and had been dropped.
because a large part of the gas supply would be priced at below market levels.\textsuperscript{73}

The chairman of the Interstate Natural Gas Association of America (INGAA), representing interstate pipelines, declared that INGAA supported the idea of nondiscriminatory transportation. However, INGAA was very concerned that the rule would aggravate the pipelines' take-or-pay liabilities because customers might exercise their rights to reduce or convert contract sales demand and then displace sales gas with transportation volumes. The pipeline group had suggested that producers be required to grant pipelines some type of take-or-pay relief before being given access to their facilities under the rule. INGAA disagreed with the Commission's conclusion that it did not have authority to include such a requirement in Order No. 436.\textsuperscript{74}

The president of the American Gas Association (AGA), representing a membership consisting mainly of local distributors with some pipelines, agreed with INGAA on the need for take-or-pay relief and suggested that the Commission require producers to grant relief in order to have access to transportation under Order No. 436. AGA also agreed with the pipeline association that the Commission had the authority to condition access in this manner. Such a condition would not violate the

\textsuperscript{73} See U.S., Congress, House, Committee on Energy and Commerce, \textit{FERC Contract Carriage Proposal}, pp. 521-524, 532. The president of the NGSA, Nicholas Bush, criticized the pipelines for not allowing more access to their facilities to transportation customers who wanted pipelines to carry gas that they already owned (and presumably bought directly from producers). He also observed that while prices had gone down at the wellhead, there had not been a corresponding price decline for end-users and he blamed this on the pipelines. See ibid., pp. 532-534.

\textsuperscript{74} Ibid., pp. 189, 192-194, 197. Like NGSA, INGAA opposed block billing but was analyzing the new proposal issued along with Order No. 436 at the time of these hearings.
*Maryland People's Counsel* decisions because it would not violate the Natural Gas Act's prohibition on undue discrimination.\(^7^5\)

An official of the Associated Gas Distributors (AGD) expressed support for the rule's provisions for nondiscriminatory transportation and for the right of customers to reduce or convert to transportation their contract demand firm sales entitlements. However, AGD stated that the rule had "several serious flaws and omissions," and agreed with AGA and INGAA that the Commission had to do something about take-or-pay provisions.\(^7^6\)

An attorney representing the Maryland People's Counsel and the National Association of State Utility Consumer Advocates "heartily" endorsed Order No. 436 and the block billing proposal. The rule "fairly responds" to the *Maryland People's Counsel* decisions and the group was "resolute in our determination to oppose any effort that is made to stop or alter the FERC rule...." The Commission was trying to restore "healthy" market pressure through Order No. 436. Pipelines were resisting, however, because (among other reasons) they wanted to continue the anticompetitive practices struck down by the court in the *Maryland People's Counsel* cases.\(^7^7\)

\(^7^5\) Ibid., pp. 268-272.

\(^7^6\) Ibid., pp. 402-404, 406. Unlike many other groups, AGD supported block billing feeling that the proposal would encourage renegotiation of contracts.

\(^7^7\) Ibid., pp. 326-328, 330, 341-346, 347-349. An official of the Process Gas Consumers Group (PGC) stated that access by all interested parties to nondiscriminatory transportation should be a major goal pursued by all in the gas industry. PGC was "most satisfied" with Order No. 436 which it characterized as "a well reasoned and well supported set of regulations designed to promote competition." The group was pleased with the transportation and the contract demand reduction/conversion provisions, however, it opposed block billing. See ibid., pp. 147, 152-154, 156-159.
Of the five cases examined in this research, the *Maryland People's Counsel* case involved a wider array of external forces exerting pressure on the Commission than did any of the other four especially when the focus shifted to the development of Order No. 436. Some of this input from the outsiders was invited by the FERC itself. In his remarks in December 1984 announcing the notices of inquiry, Raymond O'Connor had invited participation by interested parties. The Commission had solicited comments through the notices of inquiry and public conferences during the course of the formation of Order No. 436 and as just described had testified on Capitol Hill. After the proposed rule was issued, the Commission held another public conference in August 1985. In all of these settings, the Commission raised and answered questions and listened to the views of industry representatives, lawmakers, and other interested parties as it set out on a major restructuring of its regulations. The significance of this task made the Commission

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78 During his appearances before subcommittees of the House and Senate energy committees in June 1985, Raymond O'Connor observed that the FERC had received over 200 written comments during the inquiry phase of the rulemaking. The comments were from every segment of the gas industry and "provided a wealth of information and insight to guide the Commission." See ibid., p. 4; and U.S., Congress, Senate, Committee on Energy and Natural Resources, *Natural Gas Market, Hearings before the Subcommittee on Energy Regulation and Conservation*, 99th Cong., 1st sess., 1985, p. 3. In addition, in a May 1985 speech to a conference of regulatory attorneys, Commissioner Stalon described several constraints on the Commission. These included the price of oil, the price of gas at the wellhead, and the bargaining power of large customers. Stalon said that he was "studying the responses to the NOIs to help me determine more precisely how binding these and other constraints really are...." Stalon also noted that the Commission sought insight from the NOI responses on how to adjust its regulations to cope with transition problems that the pipelines were having. See Charles G. Stalon, "Finding New Objectives for Natural Gas Pipeline Regulation," speech prepared for National Conference of Regulatory Attorneys 8th Annual Convention, Hartford, Connecticut, May 13, 1985, pp. 5-7.
receptive to the views of those who would have to live with and implement the structure that would finally evolve.79

As shown in the summary of the views of the different interest groups, the segments of the gas industry often disagree over what the industry and what the Commission should be doing. In the case of Order No. 436, the transportation provisions were not as controversial as the take-or-pay or block billing portions although certain parties such as producers (NGSA) and pipelines (INGAA) were not happy with the contract demand reduction/conversion part of the transportation plan. Thus, it would appear that the Commission’s implementation of the Maryland People’s Counsel decisions (i.e. requirement of nondiscriminatory access to transportation) was not seriously threatened by the larger controversies generated by the rest of the package.80 As described in the next few paragraphs, however, there were a couple of potential legislative hurdles.

Two members of the Senate, J. Bennett Johnston of Louisiana and Don Nickles of Oklahoma, tried to block or at least to postpone the issuance of Order No. 436. Louisiana and Oklahoma are both major gas

A former member of the FERC remarked that the Commission has to pay attention to the comments received in rulemakings. In particular, the FERC pays attention when it receives a lot of negative comments on a proposal such as block billing or the original take-or-pay provisions. The assistant to Chair O’Connor described an elaborate process ("cutting and pasting") by which the FERC organized the comments received on the proposed rule so that the views of the various segments on different issues could be easily found. The Commissioners would thus have "the option to act."

A member of the Commission at the time stated that the FERC had done substantially what it wanted to do in the Order No. 436 rulemaking. However, block billing became caught up in politics. In his view, the billing mechanism was akin to "taking a meat axe" to the problems of the market. It was not crucial to the package as open access was and could be "jettisoned."

329
producing states and as shown above producers were not entirely happy with the rule, especially the block billing portion. In July 1985 Johnston proposed an amendment to the appropriations bill containing the Commission’s budget. The amendment, which was adopted by the Appropriations Committee, would have prohibited the FERC from putting into effect any regulation resulting from the Order No. 436 rulemaking. Johnston’s original proposal had been to delay implementation of the rule until 120 days after it had been submitted to the House and Senate energy committees for review. The Appropriations Committee had approved instead a provision specifying the end of the session of Congress.

The amendment died on the Senate floor in early August, however, after opposition arose from senators from consuming states. Johnston and four other senators from producing states (including Nickles) subsequently sent a letter to the FERC urging it to take more time to consider the rule before issuing it. They noted the November 1 deadline given by the court for a new transportation regulation and suggested that the FERC could issue that part of the order only while revising the others.\(^81\)

\(^81\) The idea for legislative action on Order No. 436 or the proposed rule may have come from pipeline and producer representatives who were calling for legislation in their testimony on the rule before the House and Senate energy committees. It was reported that pipelines and producers were trying to block or kill the rule through congressional action. Ironically, Senator Howard Metzenbaum of Ohio, who supported Order No. 436, was an originator of the idea of Congress reviewing the rule because of its scope and potential impact. According to one of his aides, Metzenbaum’s idea was for “modest congressional oversight” and he disassociated himself from Johnston’s plan. In the House, four senior members of the House Energy and Commerce Committee wrote a letter to the House Appropriations Subcommittee on Energy and Water Development opposing the Johnston amendment. They stated that “any efforts to direct or limit the scope of [the Commission’s] actions through the appropriations process would be an unwarranted intrusion in the independent regulatory (continued...)
Senator Nickles was perhaps the most active legislative opponent of the Commission's rulemaking. He chaired several hearings on the proposed and final rule, was a very vocal opponent of the block billing provision, and submitted comments to the FERC. As noted, Nickles was from Oklahoma, a major gas producing state so that his concerns over the FERC rulemaking were undoubtedly constituency related. He was a Republican so there would have been no partisan motivation to thwart the goals of an administration of the opposing party. However, Nickles was serving his first term having been elected in 1980 with only 53 percent of the vote. At one point he conducted hearings on Order No. 436 in Tulsa. While his concerns were probably driven by more than just desire for reelection, the opportunity for political gain was undoubtedly too great for the Senator to overlook.\textsuperscript{82}

\textsuperscript{81}(...continued) process." Consumer groups, including the Maryland People's Counsel, sent a similar letter to the Congress while the Process Gas Consumers Group claimed that the amendment would stop the transportation of over a billion cubic feet of gas per day. See "Senate Panel Throws Unexpected Roadblock in Path of Proposed Gas Rule," \textit{Inside F.E.R.C.}, July 29, 1985, pp. 1, 4; "Consumer Groups Squelch Johnston Effort to Delay Transportation Rule," \textit{Inside F.E.R.C.}, August 5, 1985, pp. 1, 6-7; and "A Group of Senators Has Recommended that FERC Take More Time....," \textit{Inside F.E.R.C.}, August 12, 1985, pp. 2-3.

Some examples of Senator Nickles's statements and actions are illustrative. In his opening statement at a hearing in September 1985 approximately three weeks before the FERC issued the final rule, Nickles said that the purpose of the hearing was "to explore the implications" of the proposed rule for the various sectors of the gas industry and "to assess its potential consequences for U.S. energy security." The Senator went on to say that he had reservations about several parts of the proposed rule but "I am particularly concerned about its block billing provisions. They have potential for decimating domestic gas exploration and development." The effects of block billing on Oklahoma would be "pernicious" and producers in thirty states might lose billions of dollars. The transportation portion of the rule would not be harmful, however. The Senator said that if that part of the proposal worked as planned, "gas consumers will gain access to new supplies of gas that they might have otherwise been denied." That increased access would also be good for producers who would be able to sell more of their product.  

83 See U.S., Congress, Senate, Committee on Energy and Natural Resources, Federal Energy Regulatory Commission's Natural Gas Pipeline Regulation, Hearing before the Subcommittee on Energy Regulation and Conservation, 99th Cong., 1st sess., 1985, pp. 1-2. Nickles also expressed the hope that the Commission "will be not only in attendance but they will be listening very attentively to the statements that are heard today, because, needless to say, we're talking about billions of dollars."

Senator Nickles expressed harsher sentiments in an opening statement at the beginning of two days of hearings on Order No. 436 in November 1985. These proceedings were held in Washington, D.C. and Tulsa, Oklahoma several weeks after the FERC had issued the rule. Nickles said that he was concerned about the pipelines' lack of participation in the program. While the Commission intended to have pipelines provide transportation service voluntarily from producers to consumers, Order No. 436 was having "the opposite effect." Producers had not gained access to pipeline facilities to market their gas directly to consumers. Pipelines were transporting less gas and producers were being shut (continued...)
Nickles, like Senator Johnston, tried to block Order No. 436 through the Commission's budget. In late September 1985, the Senate Committee on Energy and Natural Resources approved Nickles's amendment to a budget bill. The amendment would have prohibited the FERC from issuing any part of the rule, except the nondiscriminatory transportation plan required by the court, for six months following the enactment of the law. The Committee passed the amendment overwhelmingly (13-4) with Johnston among those supporting Nickles. Nickles argued that the rule would create many inequities in the industry and said "we should be setting the pricing policy, instead of this three-member board."^84

In its report to the Budget Committee accompanying the amendment, the Committee on Energy and Natural Resources said that "it is not the Committee's intent that the Commission issue Part A [the transportation portion] of the rule as proposed. Further, it is not the Committee's

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^83(...)continued

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Nickles criticized the FERC severely, saying that it "has gone way beyond reasonable action with" Order No. 436. And "not only has the FERC hurt producers, but also they've hurt consumers and I personally hold the Commission responsible for whatever economic ruin and displacement it has caused by its regulatory bungling." Unless pipelines participated in the program, there would be a "growing crisis in the natural gas industry." The lack of participation meant that the Commission had to change its regulations. Nickles again criticized block billing, calling it "the worst of all possible worlds" that would discourage gas production and increase the country's dependence on foreign energy sources. See U.S., Congress, Senate, Committee on Energy and Natural Resources, Review of the Federal Energy Regulatory Commission's Order No. 436, Hearings before the Subcommittee on Energy Regulation and Conservation, 99th Cong., 1st sess., 1985, pp. 1-2.

^84 See "Senate Panel Wants to Delay FERC Rule; No Action Taken by Commission," Inside F.E.R.C., September 30, 1985, pp. 1, 6. At the time of this action, the FERC had two vacant seats. This explains Nickles's reference to a "three-member board."
intent to allow the Commission to issue a rule providing contract demand reduction authority as proposed...." By allowing the FERC to issue the nondiscriminatory transportation plan, the Committee wanted to give the Commission "maximum flexibility to meet the requirements of the Court of Appeals" in its Maryland People's Counsel decisions.85

The "unusual intrusion" that the Committee was making into the Commission's rulemaking was justified for two reasons. First, the testimony that the Committee had received had shown "overwhelming and unprecedented opposition" to the proposed rule from all sectors of the industry. Block billing and contract demand reduction were especially targeted. Second, the rule would have replaced the "congressionally sanctioned" method of rolled-in pricing (whereby pipelines averaged the higher prices of new deregulated gas with the lower prices of old still-regulated gas to derive an average price for their customers) with block billing. Such a "fundamental and far-reaching change" should be made by Congress and not by a "regulatory agency that operates pursuant to limited, delegated authority." The Nickles amendment was needed to prevent a "'rush to judgment' on the many critical issues raised in the proposed rule."86

When the Commission issued Order No. 436 in October 1985 without the block billing provisions, Nickles was pleased and said that the amendment was probably not needed. He did not withdraw it

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85 The contract demand reduction provision was of concern to Senators Wendell Ford of Kentucky and Dale Bumpers of Arkansas. They argued that it would not be fair to allow pipeline customers such as distributors to reduce their takes from the pipeline without providing relief to the pipeline from its obligations to take gas from the producer. See ibid., p. 6; see also U.S., Congress, Senate, Committee on the Budget, Consolidated Omnibus Budget Reconciliation Act of 1985, S. Rpt. 99-146 to Accompany S. 1730, 99th Cong., 1st sess., 1985, pp. 247-248.

86 Ibid.
immediately, saying that he wanted to study the rule first. The measure may not have passed in any event as a group of senators from gas consuming states led by Bill Bradley of New Jersey was planning on fighting it.\textsuperscript{87}

One cannot be entirely certain of what the impact of Johnston's and Nickles's actions was. Undoubtedly these maneuvers did show the Commissioners the extent of the opposition to what they were doing. However, the FERC also saw that it had major supporters in the Congress for its policies.\textsuperscript{88} In addition, the fact remained that the FERC had a

\textsuperscript{87} See "Final Rule Satisfies on Transportation; Block-Billing Reaction Mixed," \textit{Inside F.E.R.C.}, October 14, 1985, pp. 1, 4-4a. Nickles continued to criticize block billing, as noted in the description of his statement at a hearing in November 1985.

\textsuperscript{88} For example, in addition to the supportive letters that the Commission received from congressional leaders that are described below, nonbinding resolutions were introduced in both the House and Senate in November and December 1985 expressing the view of those bodies that pipelines should participate in Order No. 436. See "Capitol Hill Watch: Natural Gas," \textit{FERC Monitor}, January 23, 1986, p. 9.

An assistant to Commissioner Stalon observed that the Commission took the input of members of Congress seriously. However, he stated that individual members did not have veto power over regulations and the Commission might not vote or respond in the manner that the member wanted. The assistant commented that "the United States Senate has disliked some other things we've done but we have continued to do them." The Commission had to take members' reactions seriously but "that does not mean that they dictate policy."

A member of the FERC during the Reagan administration noted that the Commission had faced much political pressure during the rule-making on issues such as take-or-pay and block billing. By "political pressure," the Commissioner did not mean "under the table or devious threats," but rather "strong political leaders making you well know that they're aware of this problem and where they stood on it." The Commissioner did not feel that a single Senator or Representative or a single committee was representative of the entire Congress. Thus, the moves made by Senator Nickles to stop Order No. 436 were mainly "posturing" although signals were sent to the Commission by such actions. Usually the signals were conflicting, coming from more than one side of the issue (continued...)
mandate from the court and it had to proceed with nondiscriminatory access to transportation regardless of congressional views. As shown, the open access requirement was exempted from at least some of the legislative attempts to block the rule. Thus, as stated previously, Commission moves to implement the MPC rulings would not have been entirely thwarted.

One might also speculate on whether the opposition of certain outsiders is more important than others (i.e. a hierarchy of outside parties within the policy subsystem). A member of the FERC in the early 1980s stated that industry groups had more impact than either Congress or the executive branch. Thus, the Commission might be more willing to listen to the views of the industry that it has to regulate and live with on an ongoing basis than the views of legislators who are only occasional although still important forces.⁸⁸

⁸⁸(...continued)

although in block billing the signals had come only from the opponents.

⁸⁹ Copies of some of the correspondence between members of Congress and the FERC obtained from the Commission's public reference office show the multiple voices, for and against the Commission's undertaking, with which the Congress spoke during the Order No. 436 rulemaking. The letters also show an awareness of the MPC decisions and the potential implications of those rulings. In January 1985 Representative Philip Sharp, chair of the House Energy and Commerce Committee's Subcommittee on Fossil and Synthetic Fuels, wrote to FERC Chair O'Connor to express his "keen interest" in the notice of inquiry on transportation that the FERC had just issued. He complimented O'Connor and the other commissioners on the leadership that they demonstrated and observed that the effort would probably be "very difficult and frustrating" at times "but I encourage you not to be deterred." He also hoped that the FERC would keep the interests of captive residential customers in mind. See Philip R. Sharp to Raymond J. O'Connor, January 16, 1985.

In May 1985, soon after the first two Maryland People's Counsel decisions were issued, House Majority Leader Jim Wright, House (continued...
Disruptiveness of the court order became prominent here after the FERC began to apply Order No. 436 to the industry. The clash between agency commitment to program and disruptiveness, which was present for example in the INGAA case, was also seen here in Commission approval of NGA section 7(c) certificates for pipelines and in Commission postponement of the contract demand revision portions of the rule. And as in INGAA, disruptiveness of the court order meant

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Minority Leader Robert Michel, House Energy and Commerce Committee Chair John Dingell and the Committee’s Ranking Minority Member James Broyhill wrote to O’Connor. The Representatives argued that the MPC decisions gave the FERC "a mandate to put in place a truly nondiscriminatory system of natural gas transportation." The court had made clear that "constructing halfway houses for transportation policy between competition and regulation" that benefitted only certain customers was inconsistent with the Commission’s responsibilities under the NGA. The Commission should "act promptly" to provide nondiscriminatory transportation for all customers. Representative Michel wrote again in June 1985 commending the proposed rule. See Jim Wright et al. to Raymond J. O’Connor, May 20, 1985; and Robert H. Michel to Raymond J. O’Connor, June 10, 1985.

Senator Nickles wrote to Chair O’Connor in September 1985 to express his "deep concern" about the proposed rule. Nickles mentioned a hearing that he had chaired earlier in September during which twenty witnesses from the various industry segments were nearly unanimous that block billing and CD reduction were bad policy. The Senator was aware of the Commission’s need to respond to the MPC decisions by the end of October and suggested that it issue a final rule only on the transportation provisions. See Don Nickles to Raymond J. O’Connor, September 23, 1985.

Senator Bill Bradley wrote in December 1985 supporting Order No. 436 as "an important step in the right direction" of fulfilling the Commission’s duty to protect consumers. He argued that CD reduction and conversion were crucial to eradicating the discriminatory access to transportation that the court had overturned in MPC. See Bill Bradley to Raymond J. O’Connor, December 9, 1985.
mainly disruptiveness for the industry moreso than for the FERC itself.  

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90 On June 17, 1985, the Commission issued a rule extending the blanket certificate program until the effective date of a final rule in its ongoing rulemaking process or October 31, 1985, whichever was earlier. This extension was two months shorter than that which the FERC had proposed before the court ruling. The Commission stated that it would apply for a stay of the court's decision in order for the extension to take effect. The FERC did not include an open access requirement as suggested by the Process Gas Consumers Group and other industrial groups because the proposed rule that it had just issued in the transportation inquiry included such a requirement. The Commission said that it was hesitant to require nondiscriminatory access before it reviewed the comments received from the industry on the proposed rule. For the views of the PGC and the industrial groups, see "Parties Continued to Urge FERC to Act Quickly on Blanket Certificates....," Inside F.E.R.C., June 3, 1985, p. 6. For the extension of the blanket certificate program, see Interstate Pipeline Blanket Certificates for Routine Transactions and Sales and Transportation by Interstate Pipelines and Distributors; Docket Nos. RM81-19-000 and RM81-29-000; Final Rule; Issued June 17, 1985, 50 Fed. Reg. 25,701 at pp. 25,701-25,703 (June 21, 1985). The court granted the stay requested by the FERC on June 28, 1985. However, the judges said that no further stays would be granted. See Maryland People's Counsel v. Federal Energy Regulatory Commission, 768 F.2d 1354 (D.C. Cir. 1985).

It was at about this time that the Commission reported on the extent of pipeline use of the blanket certificates during 1983. The FERC had issued certificates to fifty-six natural gas companies and forty actually made use of them. With respect to transportation under the certificates, the forty companies carried almost 40 trillion Btu's in 161 transactions. They earned over $9.7 million for these services. These rather large statistics probably added to the sense of urgency that the Commissioners felt in not wanting to disrupt the services being performed under the old program while the new program was being developed. See "Commission Releases Blanket Certificate Activity Report," FERC Monitor, May 30, 1985, p. 1.

With respect to the special marketing programs, the Commission argued that they were temporary and mentioned that the proposed rule incorporating nondiscriminatory access had been issued. Thus, SMPs should be allowed to continue through their expiration date of October 31, 1985. As mentioned in Chapter 3, the court remanded the orders but agreed with the Commission's request. See "FERC Faces Choice on (continued...)"
Thus, disruptiveness of the court order (abolition of old discriminatory programs and requirement of open access in Order No. 436) led to external pressure on the FERC helping (along with changes in membership discussed below) to result in variable commitment to program (less forceful implementation: section 7 certificates and delays in contract demand revisions) and a less vigorous response to the court.

Some pipelines decided to bypass the nondiscriminatory access requirements of Order No. 436 by applying for the NGA section 7 certificates. The Commission approved several unopposed certificates at the end of October 1985 and decided that contested applications would be considered through expedited hearings. FERC Chair O'Connor observed

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Transportation, SMPs: 'Stonewall' or Be Bold," Inside F.E.R.C., May 27, 1985, pp. 1, 4b-5; "Updated SMPs Meet Court's Non-Discriminatory Requirements, FERC Argues," Inside F.E.R.C., June 17, 1985, pp. 1-3; and Maryland People's Counsel v. Federal Energy Regulatory Commission, 768 F. 2d 450 (D.C. Cir. 1985) at 455. The court concluded that "it may well be that, in the short term between now and October 31, vacation of the SMP orders would do more harm than good."

One potential source of disruption for the Commission itself (rather than the industry) was that the court cut some time off the FERC timetable for completing Order No. 436. The Commission had to finish its work by the end of October 1985 rather than the end of the year as it had planned. According to a member of the FERC at the time the judicially-imposed deadline for the rulemaking "caused us a lot of trouble" because it "forced us into a rush to completion of 436." The Commissioner said that the FERC would have been better off if it had had those two or three additional months to work on the rule because there were some "tough hassles" on certain provisions of the rule such as block billing.

One of Commissioner Stalon's aides also noted that the Maryland People's Counsel decision had moved the FERC to nondiscriminatory transportation at a more rapid pace than it would have otherwise moved. At least, the decisions gave the Commission the "perception that the courts would look somewhat favorably" on nondiscriminatory access. The aide observed that "it's always nice to know that the courts are ... moving in the same direction you are."
that the D.C. Court had mandated that transportation for others be nondiscriminatory. The Commission had offered pipelines the opportunity to participate in Order No. 436 but they had the right to choose section 7 certificates instead. O'Connor said that both contested and uncontested section 7 applications would be considered in a "timely manner." 

While the pipelines were resisting participation in the new program and other parties were looking to the courts or to Congress for relief, changes in the membership of the FERC occurred that would make it more cautious and less willing to apply certain requirements of Order No. 436 as strictly. At this point, the commitment of the FERC to the policy

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The Commission's allowing of the section 7 option reflected a cautious interpretation of its authority. The section 7 certificates were discussed at a meeting of the FERC in December 1985. Commissioner Charles Stalon spoke against the use of the certificates as "mini-blankets" (blanket certificates) that the pipelines could use to move spot gas instead of an Order No. 436 blanket certificate. Commissioner Charles Trabandt argued that the Commission should not quickly issue a policy on the certificates because it might not be legally sustainable. Trabandt and Chair O'Connor observed that the Commission had said in Order No. 436 that section 7 was an alternative to the 436 program. See "Commissioner Charles Stalon Warned against Opening Section 7 Carriage....," Inside F.E.R.C., December 23, 1985, p. 4b.
that it had developed internally and which was a response to the MPC court orders entered its more variable phase.\textsuperscript{92}

The first instance of this change in the Commission’s viewpoint came in December 1985 when the FERC, on rehearing of Order No. 436, issued Order No. 436-A. This order provided for two extensions related to the contract demand modification provisions of Order No. 436. First, the order extended from December 15, 1985 to February 15, 1986 the date through which pipelines could transport gas for certain customers without the customers being able to use the contract demand reduction/conversion option.\textsuperscript{93}

Second, Order No. 436-A extended the contract demand conversion/reduction period. The original rule had allowed firm sales customers of the pipelines to reduce or to convert to transportation service their sales entitlements by 25 percent for each of four years. The intent was to free sales customers from their commitments to take pipeline gas so that they could buy gas from producers or from marketers and thus help the

\textsuperscript{92} In the summer of 1985, Commissioners Georgiana Sheldon and Oliver Richard left the FERC. Sheldon’s term expired and Richard left for personal reasons. Both of these commissioners had been involved in the Order No. 436 rulemaking process from the beginning and had been supportive of the proposed rule. Their replacements, Charles Trabandt and Clifford M. "Mike" Naeve, were more willing to listen to pipeline requests for relief and give the industry extra time to make the transition required by Order No. 436. They were joined in that view by Commissioner Anthony Sousa.

\textsuperscript{93} This extension applied to transactions executed under section 311 of the Natural Gas Policy Act enabling interstate pipelines to carry gas for local distributors or intrastate pipelines. Local distributors were the largest customers of the interstate pipelines and were very likely to use the contract demand modification options. The stated purpose was to extend the transition period of Order No. 436 through the 1985-86 heating season. All other conditions of the original rule, particularly nondiscriminatory access, would continue to apply to the section 311 transactions.
gas spot market to develop further. Pipelines were opposed to this provision fearing that their sales would be displaced and their take-or-pay liabilities would be increased. Order No. 436-A extended the conversion/reduction period to five years (15 percent in the first two years, 20 percent in the third year, 25 percent in the last two years). The purpose of the extension was to "enable pipelines to accommodate their customers' CD [contract demand] adjustments in a more orderly and smooth manner."94

The changes provided for in Order No. 436-A are probably minor in the grand scheme as the Commission had not (and could not without defying the court) abandoned the main thrust of the transportation plan. And there was no indication that the FERC was intending to retreat from the steps that it had taken in the rule, especially nondiscriminatory access. Indeed, the FERC reaffirmed its commitment to nondiscriminatory access, and denied many petitions for rehearing or a stay of Order No. 436.95

However, the Commission had viewed the rule as an integrated package and contract demand reduction/conversion was a major device


95 See in particular the discussion, "Reasonableness of Non-discriminatory Access Condition," in ibid., pp. 52,224-52,225. Underscoring the fact that the Commission was not pulling back too far from the Order No. 436 policy is the view of the two commissioners who dissented from Order No. 436-A. While contending that the new rule would increase industry uncertainty, Commissioner Stalon and Chair O'Connor stated that "all of these questions involve matters of degree where there is considerable room for reasonable minds to differ." See "Order 436-A Increases, Rather than Reduces, Industry Uncertainty....," Inside F.E.R.C., January 6, 1986, p. 9.

342
for enabling more parties to have access to the market and to transportation. By delaying the operation of that mechanism as the Commission would do in this and several successor orders, the FERC was delaying the full realization of the nondiscriminatory access that the court had ordered. In Order No. 436, the FERC had taken several large steps forward in the evolution of its policies. In Order No. 436-A it took a smaller step back and allowed external pressures and the fear of disruption of the industry to overcome its commitment to the course of action on which it had embarked.

The clash of agency commitment to ongoing program with external pressures and the increasing importance of disruptiveness can be clearly seen at the FERC meeting in December 1985 when Order No. 436-A was approved. Chair O'Connor and Commissioner Charles Stalon opposed any major changes to Order No. 436 and blamed the pipelines for using their monopoly power to disrupt the movement of gas. The other commissioners, however, were more concerned about market disruptions and the need for solutions. Sousa said that he had "serious concerns regarding what we're doing here," and that he was not certain "that everything that we're doing here is the right thing." Sousa then proposed the extension of the contract demand reduction/conversion period. He argued that the Commission had to be fair to the industry "that has communicated to us that they have a serious problem."96

96 See "Court Is Next Stop for Order 436 after FERC Makes Changes on Rehearing," Inside F.E.R.C., December 16, 1985, pp. 1, 5-6. Sousa's change of heart on Order No. 436 is interesting and crucial given that he supplied the third vote needed to delay the contract demand mechanism. Throughout the rulemaking, the FERC had listened to the views of the industry segments and other interested parties although not always incorporating those views into the rule. It is probable that Sousa did indeed have serious concerns about the rule after it had been issued and feedback was being received. At the December 1985 meeting, he (continued...)
The question of Commission commitment to Order No. 436 became a major focus in 1986 as pipelines sought to transport through section 7 certificates and the Commission continued to issue follow-up orders delaying the contract demand modification deadline. One notable example was the Commission's approval of a section 7(c) certificate for a

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mentioned the problems that the telephone industry was having under its restructuring, saying that it had been "a disaster in many quarters." See ibid., p. 5.

An examination of Sousa's reconfirmation hearing in October 1985 provides some insight into the commissioner's views on the rule. Perhaps the best indicator of Sousa's logic on the proposed rule and modifications to Order No. 436 came in response to a question from Senator Wendell Ford of Kentucky. Ford noted that Sousa had voted for the proposed rule and then asked, "at that time, what was your personal rationale for voting to issue a document that had authority for local distribution companies to reduce their contract demands by 25 percent a year for 4 years?" Sousa responded that "it was purely a notice of proposed rulemaking and it was my feeling that with the state of the industry, we would like to have as much input as possible from all segments of the industry." Sousa said that he had a "clearly open mind" at the time that the proposed rule was issued and that industry input was needed. He voted for the rule because the Commission would be holding hearings and receiving comments "and a lot of information which we did not have at that time" from the industry. When Ford asked about Sousa's support for the take-or-pay provision, the Commissioner said that he did not have any "personal feelings" at the time of the issuance of the proposed rule and that he wanted to "put the notice of proposed rulemaking out in its entirety." See U.S., Congress, Senate, Committee on Energy and Natural Resources, Anthony G. Sousa Nomination, Hearing before the Committee on Energy and Natural Resources, 99th Cong., 1st sess., 1985, pp. 7-8.

Sousa's comments at the hearing indicate that he saw the proposed rule as an experiment, a type of trial balloon that the FERC would float in order to gain information and feedback from the industry. When that feedback was negative and the industry began to grumble, Sousa balked and along with Trabandt and Naeve felt that some additional breathing space was needed.
pipeline, Texas Gas, over the objections of Commissioner Stalon. The certificate covered a large amount of gas (425 million cubic feet per day) for a sizeable number of customers (fifty-two) who had been served under the old blanket certificate and special marketing programs. The Commission noted the question of whether Texas Gas's application raised the potential for the same type of discrimination that the court had rejected in the Maryland People's Counsel case. However, no one had objected to the application and Texas Gas had pledged to seek necessary authorization if other customers wanted transportation. The Commission said that it was concerned about the possibility of undue discrimination, but authorized the pipeline's plan for one year.

Trabandt noted that in Order Nos. 436 and 436-A the FERC had not required section 7(c) certificates to include nondiscriminatory access. He believed that the Texas Gas plan was not unduly discriminatory because no one had opposed the plan and the pipeline had said that it would seek section 7 authorization for any subsequent requests for transportation services. Stalon was not persuaded by the lack of opposition to the certificate application, feeling that the FERC should not wait for parties to complain before it acted. He also argued that "I did not see 436 as an invitation to each pipeline to come in and carve out a program unique to itself."

Trabandt, on the other hand, stated that in adopting Order No. 436, the FERC "clearly held out the possibility that if transportation arrangements exactly such as this could be fashioned, where there was no evidence of undue discrimination, then in fact the commission was prepared to go forward." Trabandt also stated that if the Commission

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97 Chair O'Connor had resigned from the FERC in January 1986 and Commissioner Sousa had become acting Chair. Thus, Stalon was left to fight the battle for stricter adherence to Order No. 436 alone.
had not approved the Texas Gas application, then it signified that Order No. 436 was not a voluntary program. In that case, the order should be overturned in court as imposing a mandatory requirement on pipelines.\(^8\)

The Texas Gas case is another example of the clash of viewpoints on the Commission. As Stalon and Chair O'Connor had stated in their partial dissent to Order No. 436-A, the differences among the commissioners were mainly differences of degree. Order No. 436, like the special marketing and blanket certificate programs that it had replaced, was voluntary. The Commission did not believe that it had the authority to impose the requirement of open access. If the pipeline participated in the Order No. 436 program, however, then it had obligated itself to open access. Stalon sought a faster pace of change with the Commission more actively encouraging open access and pipeline participation in the Order No. 436 program while discouraging transportation through other means.

\[^8\] See "Stalon Loses Argument against Broad Section 7 Authority for Texas Gas," *Inside F.E.R.C.*, February 17, 1986, pp. 3-4. After the Commission's Texas Gas decision the Maryland People's Counsel asked the FERC for a rehearing of Order No. 436, claiming that the Texas Gas order had "effectively permitted the continuation of the very programs that the court ... found to be anticompetitive." The People's Counsel also argued against the view that the Commission had to approve pipeline arrangements that were not consistent with Order No. 436 because otherwise the rule would not be voluntary. According to the MPC, "rules are meant to bind" and the FERC had "misled" the D.C. Court of Appeals by "turning 1,500 pages of rulemaking orders into a 'suggested framework' that the pipelines are free to ignore." The Commission denied the People's Counsel's petition. See "Moment of Truth on Take or Pay May be Near; AGD Adds Call for Action," *Inside F.E.R.C.*, March 24, 1986, pp. 1, 6. The MPC also argued that the FERC did not intend to create a loophole for pipelines to continue discriminatory transportation through section 7(c) certificates even though Order No. 436 permitted transportation through such certificates. For the denial of the MPC petition and other petitions for rehearing, see "Sousa Unable to Muster Majority for Further Examination of Take or Pay," *Inside F.E.R.C.*, March 31, 1986, pp. 1, 6.
such as section 7(c). The other members were less enthused with that approach and more willing to allow the pipelines to develop their own programs outside of Order No. 436.99

In July 1986, the Commission held a technical conference on twenty-five applications by a pipeline, Southern Natural, to transport under section 7(c). The conference was proposed by Stalon as an attempt to define undue discrimination. The Commission then issued its order the following September, approving Southern’s applications but also placing more restrictions on the use of the section 7 certificates. Noting the "significant potential for unduly discriminatory practices and preferential treatment" when section 7 certificates were used to create a system wide transportation program, the Commissioners decided to restrict the flexibility of a pipeline to change the points where it received and delivered gas when it filed a series of section 7 applications. The previously unrestricted flexibility would be similar to that available with a blanket certificate under Order No. 436 but would not include the features of the rule that the Commission found necessary to prevent undue discrimination.100

99 The former ORA official thought that the Commission "began to pull the rug out from under the 436 program immediately when it began granting the 7(c)’s." This "was a problem that we faced" and there had been much "agonizing" over whether the Commissioners should grant the certificates but the FERC could not prevent pipelines from applying for them. The Commission was facing a large amount of pressure from the industry and did not want customers to lose service.

A former member of the Commission suggested a somewhat different view of section 7 certificates. He stated that it took two or three years to flesh out Order No. 436 and that the section 7 certificates were part of that process. A time limit of one year placed on the certificates, suggested by Naeve, made them less useful.

100 The new restrictions were suggested by Commissioners Trabandt and Naeve who both said that the technical conference had been helpful. (continued...)
Thus 1986 was a year of conflicting goals for the FERC as it implemented Order No. 436. The Commission, while still committed in main to open access (if public statements are to be believed), continued to allow the section 7 alternative although restrictions had to be placed so that the pipelines would not go too far. As Commissioner Stalon observed, the FERC did not want to be the cause of natural gas

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100(...continued)
See "Limits Placed on NGA Section 7(c) Gas Transportation," *FERC Monitor*, October 2, 1986, pp. 5, 10; and "FERC Extends Southern Natural's Section 7 Deals--With Conditions," *Inside F.E.R.C.*, September 15, 1986, pp. 1, 3-4. For articles about the conference and the issues considered, see "Southern Natural Defends Right to Seek Certificates beyond Order 436," *Inside F.E.R.C.*, July 28, 1986, p. 10; "Technical Conference Set for Review of NGA Section 7(c) Applications," *FERC Monitor*, June 26, 1986, p. 8; and "Southern Natural Transportation Applications Reviewed at FERC Technical Conference," *FERC Monitor*, August 7, 1986, pp. 4, 6. Approximately 100 people attended the conference, indicating the interest in and the importance of the issue of section 7(c) transportation. Acting Chair Sousa had opposed the technical conference, referring to it as "administrative activism to the nth degree." He supported the final order unenthusiastically. See "FERC Extends Southern Natural," p. 4. See also "FERC Toys with Definitions of Discrimination while Evaluating Programs," *Inside F.E.R.C.*, June 2, 1986, p. 3. Trabandt had supported the idea of a conference, saying that the Commission had a responsibility to consider whether discrimination existed and whether it was undue. Naeve agreed with the proposal, feeling that the Commission had to take a broader perspective that was not possible in individual cases. See "FERC Toys," p. 3.

101 In late 1986 Martha Hesse, previously an official in the Department of Energy in the Reagan administration, was appointed FERC Chair. Hesse expressed support for Order No. 436 saying that "we believe that 436 is not perfect regulation, if there is such an animal or beast. But, on the other hand, we don't want to scrap it and start over...." See "Interview: Hesse on Order 436, Managing Caseload and the Task Ahead," *Inside F.E.R.C.*, November 10, 1986, pp. 5-6. See also "Martha O. Hesse, New FERC Chairman, Outlines Priorities," *FERC Monitor*, October 16, 1986, pp. 1, 11.
not flowing in the United States. The Commission could have drawn a line, as Stalon noted, but if the pipelines did not blink first the result might have been severe shortages such as those that had occurred in the interstate market during the winter of 1976-77. Thus, a majority of

102 In an interview with Inside F.E.R.C. published in August 1986, Stalon referred to the various extensions of the deadline (December 15, 1985 to February 15, 1986 to June 30, 1986 to December 31, 1986) for carrying gas without being subject to certain Order No. 436 conditions that FERC had granted to the industry. He believed that the Commission had not fared very well in the battle of wills with the industry. The Commissioner said that "there is a sense in which, if the Commission says we are not going to disrupt the flow of gas, the Commission will do what the pipelines want. And this Commission in effect said, 'We are not going to be responsible for disrupting the flow of gas.' And by that statement, the Commission lost half the battle." The FERC was thus not fulfilling the mandate of the Maryland People's Counsel decisions or Order No. 436. Stalon felt that "... if you're going to implement 436, you had to draw a line. You had to say, 'That's it.'" See "Stalon: Commission Is Deadlocked on Waivers for Pipes' Transportation," Inside F.E.R.C., August 18, 1986, pp. 1, 4-5. See also "Without Block Billing, Discrimination 'Club' Has Big Role, Says Stalon," Inside F.E.R.C., August 25, 1986, pp. 1, 4b.

103 The year 1986 was a monumental one for the gas industry as well as it marked the first time that pipelines transported more gas than they sold. One survey of twenty-five pipelines found that they had transported 6.612 trillion cubic feet (Tcf) of customer-owned gas in 1986 while selling 6.578 trillion cubic feet. In 1985 the pipelines were transporting mainly under special marketing programs and the old blanket certificate program. That year, pipelines transported 5.231 Tcf while selling 9.382 Tcf. Comparable figures for 1984 were 4.108 Tcf of transportation gas and 11.179 Tcf of sales gas. These numbers indicate clearly that the pipeline portion of the industry was shifting from merchant to carrier of gas. Order No. 436 helped this shift, perhaps more dramatically than would otherwise have occurred. See "The Tide Turns: Pipelines Transport More Gas than They Sell in '86," Inside F.E.R.C. Special Report, April 20, 1987, p. 1. In its annual report covering fiscal year 1986 (October 1, 1985 to September 30, 1986), the Commission reported that by the end of that fiscal year forty-three interstate pipelines had filed for blanket certificates under Order No. 436. Blanket certificates were issued to eleven

(continued...)
the Commissioners was willing to give the pipelines maximum flexibility
and time to achieve the goal of nondiscrimination.¹⁰⁴

¹⁰³(...continued)

companies while two applications had been withdrawn and two were
found to be nonjurisdictional. The Commission stated that "overall, 1986
is perceived as a year of transition from NGA Section 7(c)-type applica­
tions" to Order No. 436 blanket certificates. The trend was expected to
continue into 1987. See U.S., Federal Energy Regulatory Commission,

¹⁰⁴ Stalon referred to this time, beginning soon after the issuance of
Order No. 436 in October 1985 and continuing up to the issuance of
Order No. 500 in August 1987, as the hesitation phase of the Order No.
436 program. A major factor behind the Commission's actions during this
time was the failure of the FERC to provide a solution to take-or-pay
such as block billing, which Stalon vigorously supported, in Order No.
436. Another important factor was the view of the Commission that
Order No. 436 was a voluntary program and that the FERC could not
order a pipeline to provide open access. Incentives to participate could
be provided but such actions might not be strong enough or might under­
mine the legal reasoning behind the order. Stalon argued that the
interpretation of voluntariness used by the FERC was attractive to many
both inside and outside of the Commission because it allowed pipelines
to continue to discriminate while resolving their take-or-pay problems
somewhat. The pipelines did this by using the section 7 certificates to
transport gas while requiring producers to credit against their take
requirements gas that they released and then carried for the producer or
for a merchant who had purchased it from the producer. See Stalon,

The FERC took some other actions during this time that were
consistent with the goals of Order No. 436. As noted above, the Commissi­
ioners placed restrictions on the use of section 7 certificates as an
alternative to Order No. 436. In addition, the Commissioners decided in
August 1986 that customers' contract demand reductions or conversions
that had already been exercised were still effective even if the pipeline
serving them decided to withdraw from Order No. 436. No further
reductions or conversions would be required, however. A pipeline
withdrawing from the program would have to do so on a nondiscrimina­
tory basis. In May 1986, the Commission rejected a pipeline's application
for a section 7(c) blanket certificate (filed before Order No. 436 had
(continued...)

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The comments of the commissioners and data provided by the FERC at an oversight hearing in May 1987 before the Subcommittee on Energy and Power of the House Committee on Energy and Commerce indicate continued support for the idea of nondiscriminatory access even if the pace was too slow for certain parties. Subcommittee Chair Philip Sharp, for example, was concerned that more gas was flowing under discriminatory programs than under Order No. 436 and that residential consumers were not receiving the full benefits of the rule. Commissioner Naeve corrected Sharp's assertion in responding that the "vast majority" of gas being transported at that time was being carried under the authority of section 311 of the Natural Gas Policy Act. Pipelines were not required to offer the contract demand conversion/reduction options to their customers, however the Order No. 436 requirement of nondiscriminatory transportation applied. Sharp remained worried that local distributors would not participate in the program if the FERC continued to delay the contract demand options.\textsuperscript{105}

Commissioner Trabandt, making a point similar to that made by Naeve, said that most transported gas was moving under Order No. 436. Even though the contract demand options had been delayed, the other requirements of the rule including nondiscrimination still applied. Commissioner Stalon stated that he believed that the FERC was still committed to Order No. 436. Stalon noted that he had dissented to some


Commission orders "because I don't think we've made it work as fast as I wanted to make it work and as fast as I thought we could make it work." However, Stalon believed that the FERC would "still make it work."

The data furnished by the FERC on the amount of gas flowing under the various authorizations showed that as of the middle of May 1987 most gas was being transported under the waivered section 311 authorization, 24.8 billion cubic feet per day. Much smaller amounts were flowing under the other options available: 5.3 billion cubic feet per day under nonwaivered section 311 authorization, 1.9 billion cubic feet per day under NGA section 7(c), and 0.2 billion cubic feet per day under Order No. 436 blanket certificate. The Commission also noted that 0.9 billion cubic feet of gas per day had flowed under the special marketing programs and 1.5 billion cubic feet per day had moved under the Order No. 234-B portion of the old blanket certificate program.

106 Ibid., pp. 27-28, 32. Stalon also said that the future of the order was "still within the hands of the Commission, unless the Court makes some decision that would surprise us all."

In written responses to subcommittee questions, the Commission made the point that the nondiscriminatory access requirement applied not only to blanket certificates issued under Order No. 436 but also to transportation authorized after October 9, 1985 under NGPA section 311. The Commission had, however, temporarily waived the contract demand reduction/conversion requirements for some section 311 certificates.

107 Ibid., pp. 103-104. An optimistic interpretation of these data would be that the vast majority of natural gas was being transported under nondiscriminatory access authorization, the goal espoused by the court in Maryland People’s Counsel. The pessimistic view would concentrate on the failure of the industry to embrace the new regulatory framework almost eighteen months after it had been promulgated. The Commission’s application of the nondiscriminatory access requirement to section 311 would certainly be compliance with the spirit of the MPC rulings although the waiver of the contract demand modification provisions was a step back from full realization of the court’s goals.
The evidence with respect to agency view of the court relates to the role played by the courts in policy development in this case. While the "court as legitimate authority to be obeyed" facet found in the Mid-La and INGAA cases is important here as in those previous cases, court as friend or aide in policy development, which was the original meaning of this variable, is a major aspect of the agency view of the court in MPC. The Maryland People's Counsel rulings were a victory for some of those at the Commission, such as Charles Stalon, who felt that the special marketing and blanket certificate programs were discriminatory, did not promote competition, and ought to be replaced.¹⁰⁸ By striking down these orders, the court liberated the FERC from its old policies and enabled those advocating more competition, including Commissioners Stalon and O'Connor, and Office of Regulatory Analysis Director Teclaw, to push on. As an assistant to Chair O'Connor remarked, advocates of open access could claim that "the court made us do

¹⁰⁸ A former commissioner, quoted in the trade press, said that "there are abundant signs that many people within the FERC are not displeased with the decisions and will use them as opportunities to proceed faster to their objectives of equal and separate access to a pipeline's gas supply and its transportation service." See "FERC Faces Choice on Transportation, SMPs: 'Stonewall' or Be Bold," Inside F.E.R.C., May 27, 1985, pp. 1, 4b-5. Stalon was clearly not displeased with the rulings, observing at a Commission meeting soon after the decisions were handed down that "I was not only moved by the court's opinion, I liked their logic." In a speech in mid-May a few days after the court ruled, he characterized the rulings as "very significant" and said that they would have "a dramatic impact on the outcome of the transportation NOI." Stalon was also happy with a remark in the court's opinion on blanket certificates in which the judges said that competition would be very important in protecting consumers from excessive rates. See "Pressure Mounts for Quick FERC Action in Wake of Gas-Carriage Rulings," Inside F.E.R.C., May 20, 1985, pp. 1, 5-7; and Charles G. Stalon, "Finding New Objectives for Natural Gas Pipeline Regulation," speech prepared for National Conference of Regulatory Attorneys 8th Annual Convention, Hartford, Connecticut, May 13, 1985.
it." The comments of some of those involved in the Order No. 436 process, described below, show the limited commitment of the FERC to its old blanket certificate and SMP policies and the extent to which the court helped the Commission by overturning those programs.

A member of the FERC at the time said that the *Maryland People's Counsel* decision "strengthened the ... hands of those of us who wanted to make some fairly dramatic changes." The rulings had "wiped off the board as unduly discriminatory almost every program we had out there." Thus, the Commission did not have to begin the new program by first creating an "elaborate argument" to abolish the old programs on the grounds of undue discrimination. The court had "done a very large part of our work" by performing that duty for the FERC and removing "something that was going to be very difficult for us" and would have caused "endless controversy." The decision "left us free to go forward."109

In the view of the Commissioner, the "really good thing that *Mary­land People's Counsel* did was wipe the slate clean and tell the Com­mission to rethink this policy." The court had told the Commission in effect that "you have the ability to demand nondiscriminatory carriage and you cannot use a net benefits test."110 The court had been "very hostile" to the discriminatory standards that the FERC had been using.

Another member of the FERC at this time stated that the *MPC* rulings had been helpful because they hastened the rulemaking process.

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109 The *MPC* decision was "very popular" at the Commission for those who wanted change. The Commissioner thought that Raymond O'Connor might not be entirely happy over the decisions because he had helped to create some of the special marketing programs and thus had a "proprietary interest" in those programs. But he recalled O'Connor's reaction was "God, that's a great decision for us."

110 In a net benefits test for discrimination, discrimination was al­lowed if its victims benefitted as a result.
The former commissioner, who thought that the FERC had been moving too slowly, said that he had told the People's Counsel that their case had been a good one. A third former commissioner, also happy with the MPC rulings, remarked that the court decisions had bolstered the Order No. 436 rulemaking and helped to push the FERC to nondiscrimination. The MPC orders would have been much worse for the Commission, however, if it had not been moving toward open access.

The former ORA official noted that the MPC decisions were not surprising given the discriminatory nature of the programs under review, saying "we suspected that the court would not be sympathetic to a continuation of the SMP program." The rulings were useful in that they abolished the old programs, told the industry that it did not have any viable alternatives to Order No. 436, and probably aided in the acceptance of the new rule.¹¹

¹¹ It should be mentioned that not everyone at the FERC was happy with the Maryland People's Counsel decisions. For example, one former senior official of the Office of Pipeline and Producer Regulation felt that the D.C. Circuit had not looked at the complete blanket certificate program when it made its decision. Order No. 319 allowed transportation for high-priority end users while Order No. 234-B allowed transportation for low-priority end-users so that all categories of customers were covered. SMP gas was transported through these orders to markets that would not otherwise use gas and to local distributors for up to ten percent of their contractual demand.

The MPC challenged Order No. 234-B and the special marketing programs as unduly discriminatory. The D.C. Circuit focused only on those parts of the program but ignored Order No. 319 transportation for high-priority users "for whatever reason." Order No. 319 could have been found unduly discriminatory for the same reason because it did not cover low-priority end users. According to the former official, "the problem was that they focused on one aspect of the program and said it's unduly discriminatory."

An assistant to FERC Chair O'Connor made some observations in an interview that are relevant to the points made by the former OPPR official. He noted that Order No. 234-B authorized transportation for (continued...)

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Agency view of the court as aide or legitimizer was in evidence at the May 1987 House Energy subcommittee oversight hearing as FERC Chair Martha Hesse noted that the industry was waiting for the court to rule on Order No. 436. At another point, Hesse said that the Commission was "confident" and "hopeful" that the D.C. Court would uphold Order No. 436 or at least the main parts of it. If the court remanded parts of the rule, "we will try and fix whatever needs to be fixed and go forward." The Commission did not have a plan for responding to an adverse court ruling because it wanted to see what the court decided.\textsuperscript{112}

In late June 1987 the D.C. Court of Appeals ruled in the \textit{Associated Gas Distributors} case and for the most part gave the Commission the validation that it sought. Hesse remarked that the FERC was "very pleased that the court firmly upheld the Commission's authority to require pipelines, if they transport at all, to transport on an open-access basis." She further stated that "I want to assure you that the Commission remains committed to facilitating open-access transportation." The FERC Chair stressed that the court had left the Order No. 436 program

\textsuperscript{111}(...continued)

any customer. Despite this authorization, the pipelines chose to discriminate, transporting for fuel-switchable customers and certain others. In the view of the court the Commission's mistake was that while it had authorized nondiscrimination, it had not required nondiscrimination.

\textsuperscript{112} See U.S., Congress, House, Committee on Energy and Commerce, \textit{Oversight of FERC}, p. 25. In its written responses, the Commission stated that pipelines were probably not going to commit to Order No. 436 until judicial affirmation of the program. If the court ruling was favorable, the Commission expected more pipelines to accept the program with its requirements. See p. 105.
intact for the most part and felt that the FERC should not seek a rehear-
ing of the decision.113

As described in Chapter 3, the court vacated and remanded the entire rule because of the interrelationship of its various parts. However, the main part of the order troubling the court was the Commission's treatment of take-or-pay contract provisions which the judges found insufficient. The court was also concerned about contract demand reduction.114

A member of the FERC at the time observed that the court had aided the Commission "enormously" throughout the Order No. 436 process. The MPC decisions "greatly helped the Commission" while the Associated Gas Distributors ruling "was a marvelous help to the

113 See "Statement by FERC Chairman Martha O. Hesse on Order 436 Court Decision," NARUC Bulletin, No. 27-1987, July 6, 1987, p. 11; see also "Did Pipelines Win in Court? Answer Hinges on Take-or-Pay Outcome," Inside F.E.R.C., June 29, 1987, p. 1, 4. Hesse stated that "there is only one world today, and that's the 436 world that existed yesterday, and that's the world that, until we change it, exists." The assistant to Commissioner Sousa noted that the Associated Gas Distributors decision was a surprise to the senior OPPR and Office of General Counsel staff who expected Order No. 436 to be overturned in court. The aide said that "all their [senior OPPR and OGC staff] pet legal theories ... just went down the drain."

114 The former ORA official felt that the court was misguided in its view, expressed in the Associated Gas Distributors ruling, that Order No. 436 was intended to help solve the take-or-pay problem. When the court remanded Order No. 436 in that case, the FERC then had the opportunity in Order No. 500 to explain the purpose of contract demand reduction to the court. In the view of the former official that purpose was freeing up pipeline capacity and thus helping to insure the competition at the wellhead envisioned by Congress in the NGPA. It was not the purpose of Order No. 436 to solve take-or-pay. The official felt that "FERC should have straightened the court out" and told the judges that the purpose of the rule was to "restore some order to an industry that's being torn to shreds" and that the take-or-pay contracts were already being renegotiated.
Commission." The Commissioner thought that most of his colleagues would agree. There was "widespread relief" over the AGD ruling. A fear of judicial reversal had made some commissioners reluctant to use carrots and sticks to persuade pipelines to participate in Order No. 436.

However, the Commissioner stated, an important reason for the FERC deciding to use the carrot-stick approach was the "resounding" decision of the D.C. Court of Appeals in the Associated Gas Distributors case. The court had told the Commission that it could order carriage and the staff lawyers who had been resisting mandatory carriage were "just flat out destroyed" by the ruling.\(^\text{115}\) Up to that point the pipelines had resisted Order No. 436 and the new commissioners who joined in late 1985, Trabandt and Naeve, were even more insistent on the voluntary nature of the program than was the legal staff. The use of the carrot and stick approach by providing incentives to participate or providing benefits to participants in Order No. 436 was too coercive for the new members. But when the FERC began to use carrots and sticks after AGD, saying in essence "if you want this benefit, you open up," pipelines began to participate. Incentives included the take-or-pay crediting of Order No. 500 and the abandonment policy of Order No. 490.

The evidence relating to penalties for noncompliance appears to point to a minor role for that variable in this case. Some instances are present in which noncompliance was raised but it does not seem to have been a dominant factor. This might be due to the fact that, as noted above, litigation is a routine part of subsystem operations.

One instance of penalties for noncompliance took place when the Maryland People's Counsel (MPC) went back to the D.C. Court of Appeals to contest a part of the contract demand provision of Order No.

\(^{115}\) Another former commissioner stated that some of the legal staff were very pleased with the AGD ruling.
436. If a distributor sought to exercise its right to convert some of its firm sales entitlement to firm transportation, that customer had to wait until February 1, 1986 to notify the pipeline of its intention. The conversion would not take effect for sixty more days. But, MPC said, the court ruled that nondiscriminatory transportation had to be available by November 1, 1985. By not allowing distributors to convert to firm transportation until the spring of 1986, the FERC had actually increased the level of discrimination over that of the previous winter. During the winter of 1984-85, distributors could purchase up to ten percent of their entitlement in the special marketing programs offered by the pipelines.

The MPC told the court that Order No. 436 was a "ringing endorsement" of the need and importance of access to firm transportation. However, the Commission's "unexplained decision to delay that access well beyond the ... effective date of the [court's] mandates directly contravenes those mandates and subjects consumers to irreparable injury amounting to billions of dollars." In its motion, the People's Counsel asked the court to enforce the mandate of the Maryland People's Counsel decisions.

The Commission responded that the People's Counsel's motion was beyond the scope of the court's rulings. MPC was not discussing the need for better transportation arrangements but rather the need for relief from contractual obligations to buy gas from pipelines. The problem that the MPC had with Order No. 436 was "not that LDCs and end-users are treated differently, but that LDCs and end-users are initially treated the same." The court ruled in favor of the Commission, saying that the alleged violation of the mandate was not clear enough for it to act.116

116 Emphasis in the original (in the third article cited below). See "People's Counsel Challenges Part of Rule; Tenneco Prods FERC on SMPs," Inside F.E.R.C., October 21, 1985, p. 3; "Most Pipelines Mum (continued...)
Another instance of penalties for noncompliance, although on the losing side of an argument, occurred in late 1987. In Order No. 500, the FERC set a date of November 1, 1987 for the take-or-pay crediting to become effective. Producers, end-users and others asked the Commission for an extension of the date. Commissioner Naeve supported their

Another instance of perceived penalties (or more accurately seeking to avoid noncompliance) occurred at the December 1985 Commission meeting at which Order No. 436-A was approved. Opposing the rule, Stalon argued that the FERC would not be complying with the Maryland People's Counsel decisions if it moved the contract demand modification deadline from December 15 to February 15 and said that the Commission should regulate monopoly power and not "pander to it." See "Court Is Next Stop for Order 436 after FERC Makes Changes on Rehearing," Inside F.E.R.C., December 16, 1985, pp. 1, 5-6.

As might be expected, the Commission faced external pressure when it issued the interim rule, Order No. 500, responding to the AGD decision in August 1987. One Commission official said that the order had "something bad for everybody" and it was criticized by both pipelines and producers. Pipelines were unhappy with the requirement that producers credit only the pipe actually transporting the gas. They stated that producers had access to many carriers while having contracts with only a few so that the producers could ship their gas on pipelines with whom they did not have any contracts and thus avoid having to give credits for that gas. They could still hold the pipelines with whom they did have contracts to their take-or-pay obligations. According to INGAA, Order No. 500 did not "come to grips in a meaningful way with the take-or-pay problem." The pipelines also urged the Commission to use its powers under section 5 of the Natural Gas Act to declare contract terms as (continued...)
request. He was especially concerned about the provision of the rule

117(...continued)
unjust and unreasonable.

The producer group, Natural Gas Supply Association, argued that Order No. 500 might "put an end to open-access transportation." Credit- iting had given pipelines an "absolute hammer to deny access" and had done away with any leverage that producers had in negotiations with pipelines. Pipelines could apply credits against a contract instead of negotiating a new agreement. See "With Interim Rule in Hand, FERC Waits for Authority to Implement It," Inside F.E.R.C. Special Report, August 11, 1987, pp. 1-2; "Order 500 Isn't The Answer to Take or Pay, Pipelines Tell Court," Inside F.E.R.C., August 24, 1987, pp. 1, 4-5; "All Industry Segments See Flaws in Order 500 Take-or-Pay Treatment," Inside F.E.R.C., September 14, 1987, pp. 3-4; "Claiming that Order 500 'May Put an End to Open-Access Transportation,'...", Inside F.E.R.C., September 28, 1987, pp. 9-10.

FERC Chair Martha Hesse was unsympathetic to the complaints of the various groups. Her response, "a word to the wise," was that she had not seen any arguments that would have persuaded her to make major changes. Dealing with take-or-pay had been a part of her comprehensive gas strategy for 1987. Having developed what she considered to be a fair, workable solution to that problem, the Chair was not about to be easily swayed. See "Don't Bet the House That FERC Will Make Major Changes to Order 500....," Inside F.E.R.C., September 28, 1987, p. 2. See also "Several Rulemakings Ahead under FERC's Comprehensive Gas Strategy," Inside F.E.R.C., January 19, 1987, pp. 1, 4b; and "Interim Rule Expected This Week as Hesse Presses for Agreement," Inside F.E.R.C., August 3, 1987, p. 1.

The sparring between producers and pipelines over take-or-pay was in evidence at a hearing before the Commission in April 1988. While pipelines focused on the amount of outstanding take-or-pay liability, producers noted that much had been settled through negotiations. The president of one pipeline noted a survey done by INGAA that found $7.4 billion of take-or-pay liability by the end of 1987. The president of the Natural Gas Supply Association responded that $14.5 billion of take-or-pay liability had been settled through negotiations by the end of 1987. See "Hearing Is Forum for Latest Producer/Pipeline Take-or-Pay Clash," Inside F.E.R.C., April 18, 1988, p. 3. FERC Chair Martha Hesse later characterized these industry positions as "business as usual." She concluded that Order No. 500 was working. See "Hesse Reports Electric NOPRs in Works, Eyes New Gas Data Format," Inside F.E.R.C., April 25, 1988, pp. 2-3.

361
allowing pipelines to apply credits against any contracts with a particular producer, referred to as cross-crediting. That would lead to "administrative gridlock." Sousa responded that he would not be able to support the rule if the FERC changed the cross-crediting provision. Such a change "would be almost a frontal assault on the court's decision and we're going to be in serious trouble." The FERC had to proceed with the solution that it told the court it had devised for take-or-pay.\footnote{Reflecting the view of the court as legitimate authority to be respected and obeyed, the General Counsel noted that the Commission would have "a serious credibility problem" with the D.C. Court if it delayed the crediting. The court had said that open access transportation could proceed only with take-or-pay relief and the Commission had responded that it would provide relief quickly. See "Commission to Grant Extension of Order 500, But It Won't Be Long," \textit{Inside F.E.R.C.}, October 19, 1987, pp. 1, 4-5.}

In mid-October, the Commission granted a sixty-day extension of the deadline. Sousa concurred "with great reluctance," concerned that the Commission was telling the court that it was not serious in implementing its mandate in the \textit{Associated Gas Distributors} case. He argued along with Stalon, who dissented, that the industry had had sufficient time since the rule's issuance in August 1987 to prepare for the take-or-pay crediting.\footnote{See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket Nos. RM87-34-001 through -052; Order Denying Rehearing in Part, Granting Rehearing in Part, and Modifying Prior Order; Order No. 500-B; Issued October 16, 1987, 52 \textit{Fed. Reg.} 39,630 (October 23, 1987) at pp. 39,633-39,634. Trabandt concurred in the decision, saying that the delay would provide the industry with "a more complete opportunity" to prepare for implementation of the rule. Such action was "consistent fully" with the D.C. Court's decision in the \textit{Associated Gas Distributors} case. Naeve concurred in part and dissented in part. He stated that the rule had "a number of serious practical shortcomings" that would result in gas being removed from the spot market and in price increases. One of these shortcomings involved the (continued...)}
A final instance of penalties for noncompliance took place in late 1988 when the Associated Gas Distributors went back to the D.C. Court of Appeals, asking it to order the FERC to comply with the Associated Gas Distributors decision within thirty days. The group's complaint was that the FERC had not used its powers under section 5 of the Natural Gas Act to modify contracts between pipelines and producers or its powers under section 7 of the NGA to condition producers' access to transportation on granting take-or-pay relief. The court had told the Commission to reassess its refusal to use these powers. The contracts were being renegotiated and consumers were suffering much harm as pipelines flowed through their take-or-pay costs. The court denied the distributor group's petition in November 1988.\textsuperscript{120}

\textsuperscript{119}(...continued)
cross-crediting mechanism. Naeve said that pipelines could bank their credit entitlements in cases where there were multiple owners of a producing area. If an owner did not offer credits, the pipeline could bank the entitlement. This would result in "enormous administrative complexity." In addition, producers who had accumulated sizeable banked credit obligations might not release as much gas to be transported. It should be noted that Chair Hesse voted for the extension. She was the only one of the five commissioners who did not write a separate concurring or dissenting opinion.

\textsuperscript{120} See "AGD Wants the D.C. Circuit to Give FERC 30 Days to Comply....," Inside F.E.R.C., October 24, 1988, p. 4a; see also "The D.C. Circuit's Decision in the Order 436 Case Didn't Require.....," Inside F.E.R.C., October 31, 1988, p. 4; and "AGD Motion Denied," Inside F.E.R.C., November 21, 1988, p. 10.

Data from the Commission's annual reports show that the industry was learning to live with Order Nos. 436 and 500 although perhaps more on their own terms than certain open access advocates would have liked. In fiscal 1986 (October 1, 1985 to September 30, 1986), as noted previously, the Commission reported that 43 pipelines had filed for Order No. 436 blanket certificates with certificates being issued to 11 companies. Forty pipelines had transported gas under Order No. 436 regulations implementing NGPA section 311. By the end of fiscal 1987, 51 pipelines (continued...)
The findings presented in this case are in line at least partly with the hypotheses discussed in Chapter 1. As in the previous cases, agency commitment is an important factor accounting for many of the Commission's actions although its impact was constrained somewhat by other, external, factors. Limited commitment to the pre-MPC special marketing and blanket certificate programs helps to explain more faithful implementation of the Maryland People's Counsel decisions. To be fair, it should be noted that the FERC was moving in the direction that the court pushed it by the time of the MPC rulings. However, limited commitment to its old programs made it easier for the Commission to abolish them.

Commitment to the new program was tempered and became variable when the disruptiveness to the gas industry of the court order and external pressures increased. The FERC continued to support the principle of open access and applied it in many instances but it delayed

(...continued)


The transition of the pipeline segment from merchant to transporter continued to progress during this time. As noted previously, the year 1986 was the first in which pipelines transported more gas than they had sold. In 1987 the trend was even more pronounced. In 1986, sales of twenty-four major carriers had totalled 6.476 trillion cubic feet (Tcf) and transportation gas totalled 6.583 Tcf. Comparable 1987 figures for the twenty-four were 5.188 Tcf sales and 9.413 Tcf transportation. See "Sales Only 35.5% of Pipes' Total in '87, But Throughput up 11.8%," Inside F.E.R.C. Special Report, April 25, 1988, p. 1.
the operation of the contract demand modification provisions. Thus, its response to the *MPC* decisions may not have been as vigorous as it could have been and it took the *Associated Gas Distributors* ruling to push the FERC (again) to undertake the carrots-and-sticks approach of encouraging pipeline participation in the program.

As just mentioned, disruptiveness of the court order to the gas industry is a major factor here and its influence appears to be in the expected direction. The disruption resulting from the *MPC* decisions and the new transportation program was the constraint on FERC moves to implement its policy, leading to pressure from outside interests and a pull back on the part of the FERC. Thus greater disruptiveness helps to explain the limits on the implementation of the *Maryland People's Counsel* decisions and evasion of its full consequences.

There was a variety of external pressures present in this case including not only interest group activities but also a fair amount of congressional involvement. It appears that the outsiders shouting the loudest were those in opposition to what the FERC was trying to do. The FERC might have been more willing to listen to those opponents for various reasons: it interpreted its authority narrowly and would not impose open access; it was undertaking a major innovation; it did not want to disrupt the flow of natural gas in the country; and its membership changed. Whatever the reason, greater external pressure in opposition to implementing the *MPC* decisions is important in explaining the evasion of those orders.\footnote{As described above in a previous footnote, there was also a fair amount of industry group pressure in opposition to Order No. 500 and its take-or-pay crediting issued in response to the *AGD* ruling. However, FERC Chair Martha Hesse seemed to be unfazed by it and the Commission proceeded although one deadline extension was granted.}

\footnote{121}
The FERC was committed to its policies up to a point, but disruptiveness and external pressures were powerful forces moving against commitment. The Commission, however, as well as the outsiders knew that the mandate for open access in *MPC* had to be obeyed. The fact that the transportation rulemaking had commenced by the time of the *MPC* decisions meant that view of the court could not solely account for faithful implementation, however. Positive view of the authority of the court does seem to have helped the FERC stave off some outside pressures (mainly congressional) not to implement open access.

View of the court as legitimizer and policy aide was also present here. The court was clearly seen as a friend by those at the FERC working for open access and it helped to affirm the steps that the Commission had taken (partly at the court’s prodding). The Commission sought judicial affirmation for its open access policy and proceeded more vigorously after receiving that approval in *AGD*. Positive view of the court as friend and legitimizer helps to account for implementation.

Penalties for noncompliance seems to have played a minor role here. The threat of not complying with a judicial mandate was mentioned in Commission debates and parties went to court asking for motions forcing compliance. However, the motions described above were denied and the sides raising the noncompliance issue in debate usually lost. The threat of additional litigation does not appear to be a credible one as litigation is so common in the gas policy area. Judicial review of its orders is expected by the FERC.

The supplemental hypotheses are touched on somewhat above as the relationship between disruptiveness and commitment was an important part of this case study. As already shown, agency commitment was not able to override disruptiveness (redefined to include the industry) contrary to what the hypothesis had stated. External pressure did affect commitment during the rulemaking process particularly with contract
demand revision and block billing. The final hypothesis, that greater commitment should lessen the role of external factors in determining agency response to the court, receives support here in the opposite sense. Lessened or tempered commitment to applying the new transportation program coincided with disruptiveness and external pressures being more determinative of agency response. On the other hand, the AGD ruling appears to have bolstered agency commitment to withstand external pressures.

Northern Natural

The Commission's response to the court order in this case is described in Chapter 3 as implementation although with some evasion of the broader issues involved. As shown in this section, that response is characterized by high agency commitment to its policy with the FERC trying to make a pipeline program more acceptable while also testing a limitation on its authority under the Natural Gas Act; positive agency view of the court once again as a legitimate authority for the FERC to obey; low external pressure as the case was more of a limited dispute involving the FERC and Northern Natural; low disruptiveness and low sanctions for noncompliance as the FERC gambled and accepted its loss. Although not concerned with as major an issue as other cases under study here, this case still offers insight on the interaction of the FERC with its subsystem.

Agency commitment to the program, or in this case commitment to the agency's interpretation of its authority, is a major factor in explaining the actions of the FERC leading up to the court order. The Commission was not entirely happy with the program that it approved and it added a revenue crediting requirement that Northern Natural found unsatisfactory. While the FERC may have added the crediting out of a
sense of duty to consumers who might not have otherwise benefitted (and thus to make the program more acceptable), the additional requirement may also have been part of a strategy to relitigate the Panhandle case and attempt to remove a judicially-imposed impediment to FERC authority.

There are several indications that the Commission was not very enthusiastic about Northern Natural’s flexible pricing program although it did acknowledge that customers would benefit from the additional sales that the pipeline would make. One indicator was the Commissioners’ revocation of the original certificate only two months after granting it when a customer of Northern, a local distribution company, claimed that there was no emergency justifying the special flexible rates and that the program was discriminatory.\footnote{See Northern Natural Gas Company, Division of InterNorth, Inc., Docket Nos. CP83-14-003 and CP83-14-004; Order Rescinding Temporary Certificate, 22 FERC para. 61,173 (February 18, 1983). See also "FERC Revokes Discount Industrial Rate for Northern but Not for Mich Wis," Inside F.E.R.C., February 14, 1983, p. 2. Expressing concern about judicial review of a Commission action, FERC Chair C. M. Butler said that the temporary certificate, issued two months previously to Northern, probably could not have been upheld in court.} Lack of enthusiasm may have made the FERC more willing to listen to such claims from outside intervenors although the Commissioners said that they did not agree entirely with the distributor’s arguments.

Another indicator, shown in the chronology of this case in the previous chapter, was the short three and six month extensions of the program granted by the FERC. Northern Natural, however, was requesting two year extensions and was irritated by the Commission’s treatment of the program.\footnote{When Northern applied for a two year extension in November (continued...)} After the FERC had embarked on its new policy of
open access to pipeline facilities under Order No. 436, the Commissioners decided not to renew Northern's program.

Further indicators of Commission discontent include divisions among the Commissioners themselves and among FERC staff over the wisdom of Northern's special rates. Two instances of commissioners expressing dissenting views were found. In May 1983, the FERC granted a temporary certificate to Northern after deciding that the pipeline had proven that the emergency of substantial load loss was indeed real. Commissioner David Hughes voted for the certificate although he was not sure that the special industrial rates were good policy. Hughes felt that the break given to industrial customers would eventually raise prices for residential customers and force those customers off the system.  

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123(...continued) 1984, it claimed that "regulatory uncertainty" had hampered the program and had impeded "Northern's efforts to maximize its [the program's] market acceptance." See "Northern Natural Gas Wants Authorization of its Discount Rate....," Inside F.E.R.C., November 26, 1984, p. 8.

124 See "FERC Grumbled but Went Ahead and Approved a Special Industrial Rate....," Inside F.E.R.C., May 30, 1983, pp. 7-8. Hughes also felt that some of Northern's lost sales might have been due to general economic conditions rather than exclusively to fuel switching. At the same hearing, Commissioner Sousa inquired whether any one would be hurt by the discount rates. Staff attorneys said that it was not clear but that expected benefits outweighed doubts. See "What's an Emergency? ... Facing Load Loss, Pipelines Scramble to Keep Customers," FERC Monitor, June 13, 1983, pp. 1, 5.

Hughes commented that he was "holding my nose" as he voted in December 1982 with the majority to approve the Northern program initially along with a similar certificate for Columbia Gas. He felt that the FERC should have rejected the request and forced the pipelines to renegotiate their contracts with producers. Commissioner Richard also believed that the discount rates would delay the need to renegotiate. See "Commission Reluctantly Allows Temporary Discounts for Industrial Rates," Inside F.E.R.C., December 20, 1982, p. 1.
Hughes's successor on the Commission, Charles Stalon, also was not happy with Northern's selective discount rates policy. Stalon felt that local distributors and state regulatory commissions were more knowledgeable about local market conditions than interstate pipelines and could thus respond to those conditions more effectively. In his view, Northern's program was "disturbing."\(^{125}\)

Divisions in the staff appear mainly to be the different viewpoints of different offices (the Office of General Counsel and the Office of Pipeline and Producer Regulation) of the FERC. At the same time that Commissioner Hughes was expressing skepticism about the Northern program, staff from the Office of General Counsel were arguing for the special rates. According to one staff member Northern had proven that it did have an emergency situation and needed the flexible rates for industrial customers. The counsel said that "changed circumstances have further intensified their emergency."\(^{126}\)

The Office of Pipeline and Producer Regulation (OPPR) was not as convinced as the General Counsel, however. An OPPR analyst asserted that the program was a "quick-fix approach to the current marketing problems" that would "send false market signals, suggesting that natural gas is marketable at current producer prices..." The rates could also result in undue discrimination and "could set a dangerous precedent" by

\(^{125}\) Stalon expressed this view in August 1984 when the FERC was considering and denying Northern’s application for rehearing of the revenue crediting requirement. As he had just joined the Commission, Stalon did not vote on the application. See "Commission Won't Apply SMP Conditions to all Section 311 Transactions," *Inside F.E.R.C.*, August 20, 1984, pp. 1, 5-6 at p. 6.

\(^{126}\) "FERC Grumbled but Went Ahead and Approved a Special Industrial Rate.....," p. 8.
granting preferential treatment to customers who claimed special circumstances.\textsuperscript{127}

Other indications of the FERC not being entirely pleased with Northern's proposal include the addition of more stringent reporting requirements than those imposed by the administrative law judge in order to keep a closer watch on the program and the addition of the revenue crediting requirement. The Commissioners added the requirement that Northern should pass through revenues earned from the sales to customers not receiving the flexible rates so that the noneligible customers would receive benefits from the program sooner than the next rate case. The administrative law judge had agreed with Northern that the revenue crediting would violate the \textit{Panhandle} ruling that the Commission was not to alter established rates. The Commission denied rehearing when Northern asserted that the crediting violated \textit{Panhandle}.

The Commission resorted to the revenue crediting requirement because it was felt that there were not any other real alternatives. An aide to Commissioner Sousa who had served previously in OPPR observed that the Office's staff did not advocate using the NGA section 5 procedure through which the Commission could determine by its own initiative just and reasonable rates for a pipeline. Staff did not feel that it had the resources to conduct such a proceeding successfully and was not sure that the Commissioners would want to do so in any event. Thus, in the \textit{Panhandle} case, transportation revenues were credited to sales customers through the purchased gas adjustment procedure. \textit{Panhandle} had appealed to the D.C. Circuit and had won on the argument that the

\textsuperscript{127} See "Staff Witness Firmly Opposes Northern Natural Discount Industrial Rate," \textit{Inside F.E.R.C.}, June 6, 1983, p. 8. OPPR Director Kenneth Williams, however, believed that the Commission had to react in the short term to Northern's lost customers by approving the special rates. See "What's an Emergency?" pp. 1, 5.
crediting was an impermissible adjustment of established just and reasonable rates.

The FERC then "bumped along for several years not crediting" to the purchased gas adjustment. Staff continued to be concerned about the profits ("100 percent gravy") that a pipeline could receive from special transactions such as those that Northern Natural was conducting. The volumes involved would not justify a new section 4 rate case, however, and a section 5 remedy was not considered a viable option. Staff thus decided to apply the crediting requirement to Northern, "fully expecting Northern Natural to appeal it."

The Commission, especially the rate staff of OPPR, wanted Northern to appeal to the court. The aide said that "staff and the Commission sometimes pick out companies on purpose and irritate them on purpose just to get a response out of them to take it court so we can have the question determined there." While the staff was the motivating force, the Commissioners also "knew what they were doing." The purpose was to reargue the *Panhandle* decision and the Commission "made sure that the case was clean, that we wouldn't have to argue anything else." The FERC lost, however, as the D.C. Court reaffirmed *Panhandle*. Since that reaffirmation, the Commission had been "accepting it again."\(^{129}\)

Besides agency commitment, positive agency view of the court as legitimate authority to be obeyed is another important explanation of

\(^{128}\) Similarly, a former official of the OPPR remarked that the Commission was trying to prevent Northern Natural from reaping any "unreasonable benefits" but that it was constrained by the Natural Gas Act and the *Panhandle* decision.

\(^{129}\) No other Commission official who was interviewed for this research stated that the Commission was using Northern Natural to try to overturn *Panhandle*. However, the argument does seem plausible given the Commission's attempt to reargue *Panhandle* before the full D.C. Circuit.
FERC actions here. It is reflected in the comment by Sousa’s aide that the Commission had accepted the judicial reaffirmation of the *Panhandle* decision. The positive view is also seen in the manner in which the FERC attempted to remove the impediment to its authority: by trying to convince the court to overturn its own decision. The Commission viewed the court as a legitimate interpreter of its (the FERC) authority under the law and wanted the court to modify its interpretation. When the court decided not to change its view, the FERC was forced to continue to live with the restriction.\(^\text{130}\)

**Disruptiveness of the court order** was apparently not a major variable here. According to Sousa’s assistant, the *Northern Natural* decision was not disruptive for the FERC. The aide noted that "we knew it was going to happen." The case was a "gamble" that "everyone felt that it was worthwhile making." The issues had been litigated and it was just an attempt to overturn the *Panhandle* decision.\(^\text{131}\) The narrow interpretation that the Commission gave to the court order, restricting it to

\(^{130}\) A qualifier here is that as shown in Chapter 3 above the FERC narrowly interpreted the court’s decision in this case. It is true that the Commission implemented the court’s order by vacating the revenue crediting requirement. But the Northern program had not operated for over two years by the time of the FERC order and the FERC specifically decided not to consider the wider issue of whether it should have included the crediting in the first place. In short, the Commission did accept the court’s authority but it also limited the judicially imposed restriction (a negative exercise of that authority) to the specific case.

\(^{131}\) A former senior OPPR official agreed that the ruling was not surprising given *Panhandle*. In addition to the outcome being expected, another reason for little disruptiveness was that the FERC had other ways of achieving the rate and revenue goals that it sought with the crediting. According to a former official of the OPPR the Commission could, for example, credit revenues in a rate case instead of in a section 7 certificate.
the specific case, probably made *Northern Natural* much less disruptive.

There appeared to be little major external pressure in this case. *Northern Natural* was a more limited dispute involving mainly one pipeline and the FERC. Few other parties were involved although the question of the Commission's authority under section 7 of the Natural Gas Act could have widespread implications for the gas industry. Commissioner Sousa's aide noted that there was no involvement from members of Congress in this case. It was a "technical thing that Congress wants nothing to do with." The aide also remarked that the case had not provoked much interest among industry groups.\(^{132}\)

One example of external pressure in this case can be mentioned. By the fall of 1985, the Commission was in the midst of the Order No. 436 process. *Northern Natural* had applied for a two-year extension of its flexible rates. One intervenor in the case before the FERC, the Iowa State Commerce Commission, said that an extension would not be

\(^{132}\) This is not to suggest, however, that there was no external pressure or presence in this case. For example, approximately two dozen parties filed motions to intervene when *Northern Natural* submitted its original rate application. Four parties intervened when the case was heard in court although the Process Gas Consumers Group was the only national group intervening. At one point in the court proceedings, the Commission sought input from outsiders. After oral argument before the full court, the judges asked the FERC four questions about its handling of applications under NGA section 7. The Commission then asked interested parties to comment. See "Northern Natural, Others Ponder Bounds of FERC's Section 7 Power," *Inside F.E.R.C.*, January 26, 1987, pp. 7-8. This news account describes the comments of four parties, including *Northern Natural*.

It might be more accurate to say that this case did not attract much attention from the federal gas policy subsystem. It did not become embroiled in subsystem politics in the same manner as the *INGAA* or *MPC/AGD* cases. Those latter cases, however, centered around controversies involving large amounts of revenues and upheavals in business practices.
appropriate unless the Commission decided not to continue the Order No. 436 rulemaking. According to the Iowa Commission, adoption by the FERC of the rule that it had proposed in the transportation docket would mean that the justification of programs such as Northern Natural's was not going to continue to be FERC policy. The Process Gas Consumers Group and other industrial intervenors also opposed Northern Natural’s request. The industrials said that the program was discriminatory in the same manner as the special marketing programs that the court had overturned in the *Maryland People’s Counsel* case and was "sharply inconsistent" with the proposed transportation rule. The FERC agreed, deciding not to renew Northern’s program.\^133

Likelihood of penalties for noncompliance does not appear to be important in *Northern Natural*. This case itself appears to be an act of noncompliance with the *Panhandle* decision. The FERC took a

\^133 See "Northern Natural Shouldn’t Be Allowed to Extend Flexible Rates....," *Inside F.E.R.C.*, September 30, 1985, p. 11; and "Northern Natural’s Flexible Rates to Compete with Alternate Fuels are History," *Inside F.E.R.C.*, November 4, 1985, p. 7. The Commission’s application of the Order No. 436 principles to deny Northern Natural’s request is a good reflection of its commitment to the new rule and its desire to have pipelines participate.

In applying for rehearing, Northern Natural argued that Order No. 436 was not concerned with flexible sales pricing or with competition between gas and other fuels. The order dealt with competition between different sources or suppliers of gas and with "'voluntary' opening of pipeline systems to transportation for all." Whether or not Northern decided to participate in the Order No. 436 program, "the distributors on Northern’s system are entitled to the flexible-pricing alternatives" offered by the rates that the Commission had not renewed. See "Northern Natural Won’t Give Up Its Flexible Rates without A Fight," *Inside F.E.R.C.*, November 18, 1985, p. 12. The pipeline also noted that it was developing a transportation program.

375
gamble and lost and moved on.\textsuperscript{134} Litigation does not appear to be a problem here.

Reviewing this case in light of the guiding hypotheses of this study, one finds high commitment on the part of the FERC to a course of action. When that course was overturned in court, the Commission still implemented the court’s decision although narrowly. At first blush, the Commission’s implementation of an adverse court order nullifying its policy would seem to go against the hypothesis of higher commitment leading to less faithful implementation. The FERC was certainly committed to what it was doing as it reaffirmed its course on several occasions, retaining the revenue crediting requirement in Northern’s program. The narrow interpretation, however, is probably the key here and is in accord with that hypothesis.

The effects of both agency view of the court and disruptiveness of the court order are in the hypothesized direction. Agency view was basically positive as the FERC respected the legitimacy of the court’s authority. That positive view was a factor in implementation (even if strict implementation) of the court’s decision. Disruptiveness was apparently low in this case and this helps to explain implementation.

The other two independent variables, external pressure and penalties for noncompliance, do not appear to be important factors in \textit{Northern Natural}. As noted above, the case attracted comparatively little (although some) notice from other parties and the Commission moved on. With respect to the supplemental hypotheses, agency view of the court is

\textsuperscript{134} A former senior official of the OPPR observed that as a result of the \textit{Panhandle} and the \textit{Northern Natural} decisions, the FERC had not been requiring revenue crediting in section 7 certificates. The official thought that were other ways of accomplishing the goals sought by the FERC in crediting.
as important as commitment in explaining response to the court contrary to what the hypothesis had predicted.

**Consolidated Edison**

The Commission’s response to the court order in this case is described in Chapter 3 as implementation in light of signals sent by the court. As described below, that response is characterized by high agency commitment to program as the Commission under Martha Hesse sought to continue developing its abandonment policy; positive agency view of the court as aide in policy development; low external pressure characterized mainly by input into the rulemaking; low disruptiveness as the FERC referred to Order No. 500 as its cure for the maladies pointed out by the court; and apparently low perceived penalties or sanctions for noncompliance.

Agency commitment to its program is a major factor in explaining the actions of the FERC in this case. As shown in Chapter 3, the Commission initiated a new policy on abandonment of service, one that was more market-oriented and in line with the overall approach to gas regulation being pursued in such initiatives as Order No. 436. In the Consolidated Edison decision, the court gave the FERC some indication that it would uphold the Commission’s order if the FERC considered the take-or-pay issue. As noted in the previous chapter, the Commissioners reaffirmed their decision and then issued a new order incorporating the policy.

In this case the pipeline, Transco, sought secure fuel sources and wanted to retain the supplies of the two producers seeking abandonment, Felmont and Essex, for its peak requirements and long-term reserve needs. Transco, however, was taking only 50 percent of the required gas from one producer and only 5 percent from the other. Felmont and Essex
sought a more steady year round cash flow and thus wanted to abandon their sales to Transco. The Commissioners agreed with the producers in issuing their decision in December 1985. They called the decision "extraordinarily important" and wanted the new abandonment policy to work in tandem with Order No. 436. Freeing inexpensive shut-in gas such as that produced by Felmont and Essex would, in the view of the Commission, allow the transportation provisions of the new rule to be more readily available and usable by greater numbers of producers and customers. As with its decision to terminate Northern Natural's flexible rates, the abandonment policy is an example of the Commission trying to insure that its other policies complemented the framework that it promulgated in Order No. 436.\(^\text{135}\)

Providing further evidence of its commitment to the course that it was pursuing, the Commission in 1987 undertook a rulemaking on abandonment as part of Chair Martha Hesse's comprehensive gas strategy. The goal of this strategy was "to resolve many of the natural gas regulatory policies that remain out of sync with the increasingly competitive gas marketplace." Hesse sought to remove any obstacles to competition

\(^{135}\) See "Transco Gets Approval to Expand Offshore Capacity; Manta-ray Doesn't," *Inside F.E.R.C.*, May 27, 1985, pp. 3-4; and "FERC Revises Abandonment Policy in Attempt to Push Cheap Gas to Market," *Inside F.E.R.C.*, December 9, 1985, p. 1. An official of the Office of Pipeline and Producer Regulation noted in an interview that the Commission had not been unanimous in its thinking on how to proceed with the Felmont/Essex application. Commissioner Naeve had developed the idea of comparing the needs of a purchaser with the needs of the market as a whole instead of with the needs of another purchaser. Other commissioners wanted to continue with the old policy that was replaced by Opinion No. 245. Some at the FERC may have wanted to impose conditions on the approval of the abandonment. The Commission compromised, however, and required Felmont and Essex to allow Transco and its customers to have the first opportunity to take the gas. The official said that the Commission was "very committed to opening up the gas markets and ... getting ... this cheap supply moved to market."
presented by regulation and she set a deadline of the end of April for a proposed rule.\(^{136}\)

That proposal, issued May 7, 1987, would have allowed producer to pipeline and pipeline to pipeline sales and purchases to end if the contract covering the transactions had expired or if the parties agreed to end or suspend the pact. Commission approval for every such abandonment specified by previous regulations issued under Natural Gas Act section 7(b) would not be required although the FERC would have to be notified within thirty days of the effective date of the abandonment.\(^{137}\)


\(^{137}\) See the proposed rule and its discussion of the background of abandonment regulation, Abandonment of Sales and Purchases of Natural Gas under Expired, Terminated, or Modified Contracts; Docket No. RM87-16-000; Notice of Proposed Rulemaking; Issued May 7, 1987, 52 Fed. Reg. 18,703 (May 19, 1987) at pp. 18,703-18,704. Under the Natural Gas Act, sale or transportation of gas in interstate commerce could begin only when the FERC issued a certificate of public convenience or necessity under section 7(c) of the Act. Abandonment had to be approved by the Commission to insure that supplies dedicated to the interstate market remained adequate and reliable. The Commission had decided that the service was in the public interest when it issued the section 7(c) certificate. Thus it had to confirm that the end or abandonment of the service was also in the public interest.

Some reservations about the proposed rule were expressed by Commissioners Charles Trabandt and Charles Stalon who were concerned about its effect on the dedication of gas to the interstate market. The provision of gas for interstate supply had been a purpose of NGA section 7(b). Chair Hesse's view was that dedication for the interstate market had been a priority in the past but that Congress had not provided for it in the Natural Gas Policy Act. The market would encourage sufficient exploration and production to guarantee supply. Trabandt feared that the Commission would effectively repeal that part of the NGA and he did not think that dedication of supply was an obsolete concept. Stalon suggested that only pipelines participating in Order No. 436 be allowed to use the new relaxed abandonment procedure. See "FERC Forges Ahead (continued...)"
In the midst of this rulemaking, the D.C. Court of Appeals handed down its decision in July 1987 in the *Consolidated Edison* case, remanding the Commission's order on the Felmont/Essex abandonment application. This FERC order, Opinion No. 245, had been the basis of the rulemaking and was a major step in the development of the Commission's new view of abandonment. An OPPR official observed that in responding to the *Con Ed* decision the FERC wanted to continue the abandonment initiative. He stated that "the genie was out of the bottle" and the Commission was not going to return to its old more restrictive policy.

The data obtained on agency view of the court indicates that the FERC saw the court as a legitimizer of its actions, using the orders in the *Consolidated Edison* and *Associated Gas Distributors* cases to support its new abandonment policy. Aides to Commissioners Sousa and Stalon remarked that the important point about the *Consolidated Edison* ruling was that the court upheld the new principle of abandonment. The interests of the entire market could be considered instead of just the individual parties involved. Sousa's aide noted that this principle also provoked some arguments among staff but after the retirement of Kenneth Williams from the FERC in 1986 there was no longer any major party to argue for the old principles.

Stalon's assistant noted that the decision had permitted "the Commission to basically move out of being the manager of the gas supplies of the interstate market." The Commission no longer had to be responsible for insuring that a pipeline had several years' worth of supply dedicated to its interstate market. The decision was a "linchpin" that

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380

(...continued)

enabled the FERC to proceed with the rulemaking and promulgate Order No. 490 and along with the *Maryland People's Counsel* decisions provided judicial precedent for the policies that the FERC was developing.

The external pressure here, above and beyond the court case, was mainly limited to comments and thus sparring by interested parties in the rulemaking procedure.\(^{138}\) For example, when the FERC issued the proposed rule the Interstate Natural Gas Association of America, representing interstate pipelines, observed that the proposal provided for a reduction in the obligation of a producer to serve a pipeline. The rule should thus provide for a reduction in the pipeline's obligation to serve its customers as service agreements expired and should cancel all take-or-pay obligations accumulated under contracts where service had been abandoned.

Distributors were concerned about their chances of procuring the lower cost supplies that they had traditionally been able to purchase. Pacific Gas and Electric argued that abandonments should be allowed for a limited time with the pipeline's current customers given the first opportunity to purchase the released supplies. The American Gas Association, consisting primarily of distributors and pipelines, said that the rule should require the parties initiating abandonment to provide notice and the opportunity for other parties to purchase the gas. A group of three distributors in a joint filing argued, as did INGAA, that the FERC should cancel take-or-pay claims under abandoned contracts.

Producers were supportive of the rule, although concerned about transportation of the released gas. The Natural Gas Supply Association

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138 A former commissioner said that the abandonment initiative originally had been developed internally without outsider input. The new standard that was issued in Opinion No. 245 had originated with Naeve and his staff.
argued that the Commission should require firm transportation in areas that were served by a single pipeline.\textsuperscript{139}

Outsider input was limited in deciding the Commission's response to the court remand. An OPPR official stated that the Commissioners decided how to respond and there was no procedure for outsiders to comment unless the Commission had initiated a rulemaking because of the remand. The issues in the \textit{Con Ed} remand and the Order No. 490 rulemaking were very similar, however.\textsuperscript{140}

Pipeline and producer interest groups expressed varied opinions over Order No. 490. The Interstate Natural Gas Association of America argued that producers should grant take-or-pay relief when they began the abandonment process. The Association's general counsel said that it was "extremely inequitable" that producers could obtain unilateral abandonment without providing relief while pipelines had to have a blanket certificate. According to the counsel, Order No. 490 "flies in the face" of the \textit{Consolidated Edison} decision and would "inevitably increase" the pipelines' take-or-pay problems. On the other hand, the producer Natural Gas Supply Association was "basically pleased" with the order. NGSA

\textsuperscript{139} See "Transportation Issue Draws Most Fire in Abandonment NOPR Response," \textit{Inside F.E.R.C.}, June 22, 1987, p. 4a; see also "Abandonment NOPR Draws Questions about Future Role of Pipelines," \textit{Inside F.E.R.C.}, June 29, 1987, pp. 5-7. The Maryland People's Counsel argued that the FERC should delay action on abandonment until the transition under Order No. 436 was complete and the market was competitive. Only pipelines that had accepted "unconditional" certificates under Order No. 436 should be allowed to take advantage of the new procedure.

\textsuperscript{140} The official noted further that communications between outsiders and staff or commissioners on current contested cases would violate the ex parte laws. Outsider input would be greater in a rulemaking because such input would be sought in the notice of proposed rulemaking.
would have preferred that the FERC require pipelines to transport abandoned gas regardless of whether they had a blanket certificate.\(^\text{141}\)

The disruptiveness of the ruling in *Con Ed* was apparently low. When considering this variable, it is important to note that the court had remanded Order No. 436 the previous month for basically the same reason (insufficient treatment of take-or-pay). Some at the FERC believed that the Commission would be able to address the take-or-pay concerns of both court remands with the same rulemaking: the process that resulted in Order No. 500 which reinstated Order No. 436 for the most part while adding a take-or-pay crediting provision. The Commission, however, apparently was not entirely certain of the effect of the *Consolidated Edison* decision on its ongoing abandonment rulemaking. Some Commission officials thought that there might be an effect on the rule while others believed that the court had supported the core of the Commission's policy and thus protected the rule.\(^\text{142}\)

An OPPR official felt that the court's decision was not disruptive for the FERC. He said that the Felmont decision was a "stopgap arrangement" until the Commission had further developed its abandonment policy and that the *Consolidated Edison* case had just "popped in." In the Felmont decision, Opinion No. 245, the Commission began developing the new policy by stating the principle of comparing the needs of a buyer with the needs of the market as a whole.

The little evidence collected on likelihood of penalties for noncompliance here suggests a pattern similar to that found in other cases. Fear of further litigation did not appear to be a major factor in

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how the Commission decided to respond to the *Consolidated Edison* decision. An OPPR official observed that interest groups "are going to litigate no matter what you do." The pipelines were on one side and the consumers were on the other and "whoever disagrees with you is going to litigate." Thus, the Commission tried to "come up with reasoned decisions that can pass court muster."

In examining the findings of this section with respect to the hypotheses discussed in Chapter 1, one finds that high commitment by the FERC to its abandonment policy helps to explain the implementation of a court order remanding that policy. This seemingly contradictory finding can be explained by the fact that the court, while indeed overturning at least temporarily a cherished policy, had sent signals to the FERC that it would uphold that policy if certain changes were made. The Commission moved in the direction sought by the court, using the rulemaking initiated to respond to the remand in *Associated Gas Distributors* and thus "killing two birds with one stone," and implementation followed. In this case commitment appears to be the dominant factor in explaining the Commission's response to the court.

Positive view of the court is important here also. The FERC won judicial affirmation of its new abandonment principle despite the remand of the order. The court legitimized the new approach and enabled the Commission to proceed.

External pressures appear to have not been overwhelming. They came mainly in the form of input into the rulemaking and the opposing sides may have cancelled each other. Low external pressure appears to have been overshadowed by the strong commitment of the FERC to its policy, corresponding with the expectations of that particular hypothesis.

The findings on disruptiveness are in accord with the hypothesis. The *Con Ed* ruling was apparently not disruptive for the FERC probably because of the signals sent by the court on its willingness to affirm the
policy and because of the ongoing Order No. 500 rulemaking. Lesser disruptiveness was a factor, if not the major factor, in implementation.

The data on penalties for noncompliance admittedly are not very great but they are in line with the other cases. Those perceived penalties and sanctions were low here as litigation was probably expected regardless of the course of action pursued by the FERC.

The conclusion with respect to the supplemental hypotheses repeats what is said above about the dominance of agency commitment in this case. It appears that commitment did override disruptiveness and low penalties in framing agency response. Agency commitment also was more important than external pressures and view of the court.

Concluding Observations on the Five Cases

The discussion in Chapters 3 and 4 includes a large amount of information and analysis relating to FERC natural gas regulation. Before proceeding with the cross-case examination in this section, a summary of each of the five cases is provided first as an aid and a reminder for the reader.

In Mid-La, the Court of Appeals for the Fifth Circuit vacated two FERC orders in which the Commission had sought to set the maximum lawful price for natural gas transferred from the production division to the transportation division of a pipeline company. This decision was partially affirmed by the U.S. Supreme Court which agreed that the FERC had incorrectly excluded the intracorporate transfers of gas from the NGPA "first sale" category and remanded the case to the Commission.

The FERC responded in Order No. 391 issued in August 1984, \(^{143}\)

\(^{143}\) See Production under Section 2(21) of the Natural Gas Policy Act (continued...)
designating as first sales the intracorporate transfer of gas from a pipeline’s production division to its transmission division and sales by affiliates. The FERC response to the court included several other actions constituting both implementation and evasion. For example, after the Fifth Circuit ruling the Commissioners decided to allow pipelines to file to pass through to their customers the increased gas costs resulting from the higher NGPA pricing of their own production. However, they also decided by a majority vote to appeal the case to the Supreme Court and they made other decisions limiting the ability of some pipelines to take advantage of the *Mid-Louisiana* ruling.

Agency commitment to a policy (not using NGPA pricing for the intracorporate transfer of fuel) that was achieving FERC goals and that was felt to be in line with congressional intent was a prime factor motivating FERC behavior in this case. Agency view of the court as a legitimate force that had to be obeyed was also crucial. External pressure, consisting of comments by interests in rulemakings and some litigation, had some effect but was not as strong as in other cases such as *INGAA*.

In *INGAA*, the U.S. Court of Appeals for the District of Columbia vacated a rule in which the FERC had changed the standard for measuring the energy content of gas for the wellhead pricing purposes of the Natural Gas Policy Act (shifting from the "wet" rule to the "dry" rule). The court ruled that this shift violated the pricing scheme embodied in the NGPA. The FERC amended its regulations in response to the court decision by issuing Order No. 356 on January 19, 1984,\(^\text{144}\) requiring the

\(^{143}\) (...continued)


\(^{144}\) See Interpretive Rule for Btu Measurement Standard under the Natural Gas Policy Act of 1978; Interpretive Rule; Docket No.

(continued...)
use of the standard test conditions, the "wet" rule, to determine the number of Btu's in gas. The FERC issued Order No. 399 in September 1984 implementing a system of refunds by producers of the excess revenues collected under the dry rule. The Commission, with the support of producers, then reversed itself in November of that year, issuing Order No. 399-A allowing the offset of the Btu refunds against certain costs owed by pipelines to producers. When the offset was overturned by the D.C. Court, the FERC issued Order No. 399-B in July 1985 vacating the offset and ordering the producers to pay the refunds.

Agency commitment, based upon the Commission's perceived statutory duty to insure that proper prices were paid, was crucial in the promulgation of the dry rule and in ordering refunds. Agency view of the court as legitimate authority to be obeyed was important as in Mid-La. External pressure, deriving from the disruptiveness for the industry of the FERC and court orders and from the large amount of revenues involved, was substantial and was a major factor in the Commission decision to allow the offset.

144(...continued)

145 See Refunds Resulting from Btu Measurement Adjustments; Final Rule; Docket Nos. RM84-6-000, RM84-6-001, and RM84-6-002; Order No. 399; Issued September 20, 1984, 49 Fed. Reg. 37,735 (September 26, 1984).

146 See Refunds Resulting from Btu Measurement Adjustments; Order Granting in Part and Denying in Part Rehearing; Docket Nos. RM84-6-003 through 014; Order No. 399-A; Issued November 20, 1984, 49 Fed. Reg. 46,353 (November 26, 1984).

147 See Refunds Resulting from Btu Measurement Adjustments; Order on Remand and on Petitions for Rehearing and Reconsideration; Final Rule; Docket Nos. RM84-6-015 through 028; Order No. 399-B; Issued July 18, 1985, 50 Fed. Reg. 30,141 (July 24, 1985).
In *MPC/AGD*, the U.S. Court of Appeals for the District of Columbia struck down special marketing and transportation programs approved by the FERC. The programs were designed to keep noncaptive, mainly large industrial, customers with the capability to switch fuel on a pipeline's system and excluded captive, generally residential, customers. The court ruled that the FERC had not reasonably assessed whether the special marketing program would benefit all of the pipeline's ratepayers and had not evaluated the anticompetitive consequences of the transportation program. Order No. 436 was already in preparation at the time of the *MPC* rulings so it was not entirely a response to the court, but it did move FERC policy in the direction that the court sought. The transportation provisions included the requirement of nondiscriminatory access to transportation for those pipelines participating. Transportation service and the allocation of pipeline capacity would have to be furnished on a first-come, first-served basis.¹⁴⁸

When the D.C. Court remanded Order No. 436 back to the FERC in the *AGD* decision, a main reason was the failure of the Commission in that order to take sufficient action on uneconomic contracts. The FERC responded with Order No. 500¹⁴⁹, implementing a system of transportation credits whereby a pipeline could refuse to carry a producer's gas unless the producer offered to credit the transported fuel against the pipeline's take-or-pay liability to the producer.

¹⁴⁸ *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Final Rule and Statement of Policy; Docket No. RM85-1-000 (Parts A-D); Order No. 436; Issued October 9, 1985, 50 Fed. Reg. 42,408 (October 18, 1985).*

¹⁴⁹ *See Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol; Docket No. RM87-34-000; Interim Rule and Statement of Policy; Order No. 500; Issued August 7, 1987, 52 Fed. Reg. 30,334 (August 14, 1987).*
Agency commitment was important in shaping agency response although constrained somewhat by other factors. Agency view of the court as legitimate authority and as aide in policy development was important. There was major external pressure (in court, before the FERC, and in Congress) that like INGAA was derived from the disruptiveness of the FERC order and the stakes involved and helped to modify the FERC response.

In *Northern Natural*, the U.S. Court of Appeals for the District of Columbia vacated part of a Commission order approving a gas marketing program for that pipeline. The FERC had imposed the requirement that customers of Northern who were not eligible to take part in the program should receive revenues that the carrier earned from the sales. The D.C. Court, reaffirming one of its previous decisions, said that the Commission's stipulation was a modification of previously approved rates. The Commission would have to use a section 5 (NGA) proceeding to change such rates and not a section 7 certification procedure. The FERC issued an order vacating the revenue crediting requirement but not considering the larger issue of whether a different condition should have been imposed.150 Agency commitment to policy or interpretation of authority was a key factor along with positive agency view of the court as legitimate interpreter to be obeyed. There was little external pressure.

In *Con Ed*, the U.S. Court of Appeals for the District of Columbia vacated a Commission order establishing a market-based policy of abandonment of service by a producer to a pipeline. The court found that the policy could harm the position of pipelines in their negotiations with producers over contracts requiring the pipelines to take gas that they

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150 See Northern Natural Gas Company, Division of InterNorth, Inc., Docket Nos. CP83-14-123 and CP83-14-124; Order on Remand Vacating Conditions, 42 FERC para. 61,044 (Issued January 21, 1988).
could not sell. The FERC responded in an order issued in February 1988, stating that the new abandonment policy was "a proper and beneficial adjustment" to its regulations due to the current gas market conditions and the changes caused by the Natural Gas Policy Act. The Commissioners asserted that because of other actions taken (Order No. 500 issued in response to the AGD ruling) any bad effects of the policy on pipeline take-or-pay problems were not likely to outweigh the benefits.\textsuperscript{151} Agency commitment to a new course of action, the abandonment policy, was a major force along with positive view of the court as aide in policy development (legitimizor of the new approach). External pressure was limited to comments and sparring in the rulemaking and was not as influential here as other factors.

A good way to begin this part of the discussion is to return to the two questions stated at the beginning of this chapter: how does the FERC respond to a court order directing it to do things differently (i.e. what does it do and why?) and what is the role of external pressure in shaping the Commission's response? The characterization of the FERC response to the court, whether implementation or evasion as discussed in Chapter 3, is presented below along with the observations in this chapter about the magnitude of each of the independent variables for each case.

*Mid-Louisiana:* Implementation and evasion concurrently followed by implementation after second court ruling  
High commitment to program  
Favorable view of court  
Some external pressure  
Low disruptiveness  
Low perceived penalties for noncompliance

\textsuperscript{151} See Felmont Oil Corporation and Essex Offshore, Inc., Docket No. CI84-10-006; Order on Remand Reaffirming Prior Determination, 42 FERC para. 61,172 (Issued February 5, 1988) at p. 61,613.
**INGAA:**  Implementation and evasion concurrently followed by implementation after second court ruling  
High commitment to program  
Positive view of court  
Major external pressure  
High perceived disruptiveness  
Some perceived penalties for noncompliance

**MPC/AGD:**  Implementation limited somewhat by evasion/caution (**MPC**); implementation after **AGD**  
Limited commitment/variable commitment to program  
Positive view of court  
Major external pressure  
Increasing disruptiveness  
Low perceived penalties for noncompliance

**Northern Natural:**  Implementation in form of narrow interpretation; evasion/avoidance of full consequences of ruling  
High commitment to program  
Positive view of court  
Low external pressure  
Low disruptiveness  
Low perceived penalties for noncompliance

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152 In Table 4.1 below, the impact of the independent variables on the dependent variable is evaluated. **INGAA 1** and **INGAA 2** are considered separately in that table in order to aid in the analysis and to highlight some differences between those two cases. The separation is made here also in order to prepare the reader for that subsequent discussion.

**INGAA 1:**  Implementation and evasion concurrently  
High commitment to program (dry rule)  
Positive view of the court  
External pressure from all major parties  
High disruptiveness from refunds  
Some perceived penalties (for allowing offsets)

**INGAA 2:**  Implementation  
Commitment to offsets but also to refunds  
Positive view of the court  
External pressure from all major parties  
High disruptiveness from refunds  
No perceived penalties for noncompliance

391
**Con Ed:**
- Implementation (in light of signal from court)
- High commitment to program
- Positive view of court
- Low external pressure
- Low disruptiveness
- Low perceived penalties for noncompliance

The answer to the first of the two guiding questions appears to be that the FERC generally implements the court's order although with varying degrees of enthusiasm. Only in the *Con Ed* case was implementation not qualified somehow and that was in light of favorable messages from the court. The Commission's actions in these five cases make sense for two main reasons, both in accord with the hypotheses laid out in Chapter 1. First, as one can see from the above chart agency commitment to its program was strong in almost all of the cases. As hypothesized, stronger commitment should lead to less faithful implementation of the court order. This would account for some of the evasion such as that which occurred in *Mid-Louisiana*. Second, as also seen above, agency view of the court was positive. Positive view was hypothesized to lead to more faithful implementation of the court's orders. The court was a legitimate authority to be obeyed. Strong commitment to the overturned policy might mean that that obediance was not wholehearted but there was still obediance.

This strong role for view of the court, redefined from its original friend-foe dichotomy, is somewhat surprising although sensible from Shapiro's viewpoint of the judicial overseer of the bureaucratic supplemental lawmaker. It was expected that other pressures originating within the policy subsystem (i.e. the agency's own commitment and external pressures) would be much more important. Those other forces are quite influential but the deference given to the court is also a strong motivator.
The second guiding question is concerned with the role of external pressures in shaping the FERC response to a court order directing it to do things differently. Of course there is always some external pressure on the FERC given the nature of natural gas regulation and the subsystem context. In two of the five cases, *Northern Natural* and *Consolidated Edison*, the external pressure appears to have been more of the routine, normal interaction growing out of rulemakings and case by case proceedings. In those cases the external pressure does not seem to have been overly influential in shaping FERC response. There was slightly more external pressure in *Mid-Louisiana* involving additional judicial proceedings. In *Mid-La*, however, it was fairly clear what course the Commission had to pursue.

Not surprisingly external pressure appears to be strongest in those cases with the most widespread implications for the industry: here the *INGAA* and *Maryland People's Counsel/Associated Gas Distributors* cases. The implementation of Order No. 436 and the Btu refunds had major potential effects in terms of operating conditions and transfer of revenues. With respect to Order No. 436, the FERC faced intense pressure not only from the industry but also from members of Congress particularly over block billing and to a lesser extent the contract demand revision part of the transportation provisions. In the Btu refund case, the industry segments were locked in a struggle over a large amount of money. In both of these cases, the Commission gave in somewhat to the outside pressure by dropping block billing, delaying contract demand revision, and approving the offset. As hypothesized, greater external pressure in opposition to the court order helped lead to evasion or less faithful implementation.

The catalyst for the external pressure in both *MPC/AGD* and *INGAA* was the disruptiveness of the court's order. Although not
originally intended to be so, disruptiveness became related to external pressure as the research on these cases proceeded. This variable is important particularly when it is viewed as disruptiveness for the gas industry (and thus for a larger part of the subsystem) as seen most clearly in the two cases just mentioned. In both of those cases the hypothesized relationship of high disruptiveness and attempts to limit or evade the court order are seen. The disruptiveness of the court orders in INGAA and MPC led to external pressure on the FERC.

The first INGAA ruling striking down the dry or as delivered rule was somewhat disruptive for the Commission as staff had to oversee a large refund process. However, the major concern, particularly for Commissioner Richard and the other commissioners who voted to use the offset, was the impact of the refund process on the gas industry. As noted in the discussion of that case, the industry was the actual implementer of the court's decision. In Maryland People's Counsel a majority of the FERC expressed concern about policies that the Commission was forcing on the industry and the resulting potential for disruption. In the other three cases disruptiveness did not appear to be a major factor. Low or nonexistent disruptiveness did not interfere with implementation.\(^{153}\)

\(^{153}\) The views of some Commission officials interviewed for this research provide some further insight on the disruptiveness of the decisions for the FERC. A former OPPR official felt that the five court cases under consideration were not so much disruptive for the FERC as "frustrating." This was especially true of the Maryland People's Counsel decisions. The Commission felt that it was "going in a direction that would be compatible with where they wanted to get to. Those cases really caused them to go back to the drawing boards and start all over again." The Mid-Louisiana decision was disruptive to the extent that the FERC had to "essentially drop the path that it thought was appropriate and say, and just toss up their hands and say, 'Okay, if that's the way you're going to interpret it, then we'll have to live with that interpretation.'"
Likelihood of penalties in the form of litigation and further adverse court rulings does not appear to have been a major factor in these five cases. The main reason for its nonimportance is that litigation of Commission orders is frequent and thus expected. Litigation and judicial review are part of the business operations of the gas policy subsystem and the Commission for the most part does not appear to view the likelihood of its actions being reversed in court as a major penalty. In fact, as shown in the Northern Natural case, the Commission took a risk of losing in court as part of a strategy to have a disliked precedent overturned.\(^{154}\)

\(^{153}\)(...continued)

The INGAA decision had a similar effect as the Mid-Louisiana decision. In INGAA, the Commission was trying to interpret the intent of Congress and the court said that it had misinterpreted. The FERC realized that the court's interpretation was a reasonable possibility but the unraveling of the payments through the requirement of refunds by the producers was a "nightmare." It was especially difficult with respect to the refunds from the small producers who might not have had the refund money because they had gone bankrupt or put the money into extra wells. The Commission had to "wrestle" with a whole host of issues coming out of the refund process for years afterwards.

Commissioner Sousa's aide also did not feel that the five cases being considered here were very disruptive. He noted a Commission joke of "Commission proposes and the court disposes." If the court gave explicit directions on how the Commission should respond, the FERC would rewrite the order "grudgingly" incorporating the court's instructions. If the court was not explicit on what to do in the remand, the Commission would "just presume the court didn't understand what we're saying and try it again" unless the membership had changed.

\(^{154}\) In an interview with a Commission publication, the Associate General Counsel for Rulemaking and Policy Coordination commented that "frequently, the Commission is willing to risk a court challenge in order to implement a program in a way it believes best serves the public interest." See "Monitor Interview: Lynne H. Church, Associate General Council [sic] for Rulemaking and Policy Coordination," FERC Monitor, December 29, 1983, p. 3. On the other hand, as seen in the debate over (continued...)

395
The results of this research prove to be mixed regarding the four supplemental hypotheses. At times, as hypothesized, external pressures did affect agency commitment to program at different stages of the rulemaking process. This was most notably true in INGAA and MPC/AGD which were the biggest cases in terms of impact on the industry. There was no support for or insufficient data to comment on this hypothesis in the other three cases.

There is also partial support for the second hypothesis. Agency commitment was generally a more important force than likelihood of penalties for noncompliance in shaping agency response to the court. However, commitment did not always override disruptiveness of the court order particularly when disruptiveness included the gas industry instead of just the FERC (i.e. INGAA and MPC/AGD).

The third hypothesis receives little support from this research. Agency view of the court played a very important role in these cases and appeared to be equally or more important than agency commitment in many of them. Examples of this latter point are Mid-Louisiana, INGAA, and Northern Natural.

154(...continued)

the use of the offset procedure in the Btu refund case and at various times during the implementation of Order No. 436, members of the FERC expressed concern over actions that the Commission was taking and how those acts strayed from the mandates of the court.

The observations of a former OPPR official who was interviewed for this research are relevant for this discussion about the risks of litigation and any penalties for noncompliance. Commenting on the threat of further litigation arising out of its rulemakings or responses to court actions, the former official stated that the FERC recognized that the rules that it developed were not going to please everyone. One would be lucky if half of the parties were satisfied. Even groups that would support the rule generally would still be dissatisfied with parts of the regulations. Thus, the Commission realizes that court action is inevitable for rules that have major impact. Court action is also automatic for parties that lose a major case before the Commission.
Given what is said above about the influence of external pressures and disruptiveness, it is clear that the hypothesis that greater agency commitment should result in less of a role for external pressures is not fully supported. In fact, the picture appears to be somewhat muddy. The Commission seems to have been committed to its policies in all five of the cases albeit with somewhat lesser support for the pre-\textit{MPC} transportation policies. And that commitment was generally a major factor in determining agency response to the court. External pressure was not present to a great degree in all five cases and may not have had the impact that was expected (from what is said in Chapter 1). However, it did have impact in the major cases despite agency commitment.

The research results and the conclusions regarding these four hypotheses show that different variables are important at different times, sometimes unexpectedly. This applies both to influence over agency response to the court and to relative influence among the various independent variables.

The relationship between the independent and the dependent variables as discussed throughout this chapter is summarized below in Table 4.1. The table shows the characterization of the Commission's response (implementation or evasion) and the factors, positive and negative, that produced that response. Some observations can be made both within and across cases, beginning with the former. The three cases
Table 4.1: Relationship between the independent variables and the dependent variable in the five cases.
in the top part of the table are more straightforward. In *Mid-La* and *Northern Natural*, FERC commitment to its programs (NGA pricing for pipeline produced natural gas and imposing conditions on section 7 certificates) worked against faithful implementation of the court orders overturning those policies and is thus coded negatively in those two cases. In *Con Ed*, however, commitment aided implementation because the Commission made the changes required by the court in order to salvage its abandonment policy. Commitment is coded positively in *Con Ed*. View of the court had a positive impact throughout the three cases (legitimate authority to be obeyed) while the other three independent variables had little impact.

The *INGAA* and *MPC/AGD* cases contain a more varied mix of factors. In *INGAA 1* striking down the dry rule, FERC commitment to that rule, the disruptiveness for the subsystem of the court order (i.e. refunds) and some external pressures (those arising from the producers) had negative effects on implementation and resulted in evasion (offsets). Positive view of court (authority to be obeyed), other external pressures from pipelines and distributors, and the raised threat of penalties were positive forces for implementation. In *INGAA 2* striking down the offsets, FERC commitment to offsets was a negative factor for implementation although the simultaneous commitment to a refund policy was a positive force. The disruptiveness of refunds continued to be a negative factor while external pressures again fell on both sides and view of the court had positive effects on implementation.

Many of the variables are positive factors in the *MPC/AGD* case. FERC commitment to the old transportation policies was limited (thus assisting implementation of an order overturning them) and application of Order No. 436 was variable but generally in the direction of implementation. Commitment is thus coded positively. The view of the court was
positive throughout and external pressure worked in both directions. Disruptiveness for the industry had negative effects and was partly if not wholly responsible for the negative external pressure. Although not a major factor, penalties for noncompliance were raised and tilted positively in the direction of implementation.

Table 4.1 also includes implementation scores for each of the cases. These are relative rankings based on a five point scale with 1 signifying evasion and 5 indicating implementation and are representative of the single dimension of the dependent variable discussed above in Chapters 1 and 3. The actual scores shown in the table reflect the view that the FERC generally implemented each court order although with varying degrees of enthusiasm and with some slippage in certain of the cases. They are admittedly a judgment by the author on where the FERC actions would fall on the five point scale but they are useful and necessary for their intended purpose: ranking the five cases to evaluate further the relationships between the independent and dependent variables (in Table 4.2 below).

Several points can be made across the five cases. First, Table 4.1 shows the consistently positive effects of agency view of the court on implementation, resulting from the redefinition of that particular independent variable from political actor to legitimate authority. On the other hand and not surprisingly, disruptiveness has a generally negative effect on implementation. While view of the court is the major positive factor in these cases, disruptiveness (as redefined and in those instances where it is present) is the major negative as it ignites substantial external pressures on the FERC.\footnote{The aforementioned redefinition of agency view of the court reflects Commission willingness to listen to and obey an authoritative branch of government rather than decide whether or not to submit to the (continued...)}
<table>
<thead>
<tr>
<th>Case</th>
<th>Imp. Score</th>
<th>Cmt</th>
<th>ExP</th>
<th>Dis</th>
<th>Pen</th>
</tr>
</thead>
<tbody>
<tr>
<td>Con Ed</td>
<td>5</td>
<td>+</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>INGAA 2</td>
<td>5</td>
<td>+/-</td>
<td>+/-</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>N. Nat.</td>
<td>4</td>
<td>-</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mid-La</td>
<td>3.5</td>
<td>-</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>MPC/AGD</td>
<td>3.5</td>
<td>+</td>
<td>+/-</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>INGAA 1</td>
<td>3</td>
<td>-</td>
<td>+/-</td>
<td>-</td>
<td>+</td>
</tr>
</tbody>
</table>

Table 4.2: Positive/negative effects of the independent variables on the dependent variable in the cases.

The data from Table 4.1 are rearranged in Table 4.2 above to compare across the cases the values of the independent with the dependent variables. One independent variable, agency view of the court, has been excluded from this part of the analysis because its value (positive) did not vary. Of the four remaining independent variables, agency commitment appears to fit best. The trend for this variable is a positive value in the cases with the highest implementation scores with that value becoming more negative as agency response becomes more evasive. The result for MPC/AGD is the notable exception to the trend.

<sup>155</sup>(...continued)

views of a mere political actor. As the major positive factor, it appears largely responsible for pushing the FERC away from the evasive end of the scale and thus there is no score lower than 3.
The external pressure variable does not change with agency response quite as cleanly as does commitment. Given the nature of subsystem politics, there are both positive and negative external pressures in the major cases although there were strong negative pressures in the cases with the lower implementation scores. Similarly, disruptiveness has a strong negative presence in the cases with the lowest scores. That result is not too surprising when one recalls the nature of the variable both as originally defined (disruption for the agency) and especially as redefined (disruption for the subsystem). Both of these variables, external pressures and disruptiveness, tilt toward the evasion end of the scale. Penalties for noncompliance, on the other hand, seem to go against the grain appearing as a positive presence in the cases with the lower implementation scores.

This table points up the importance of agency commitment as a barometer of FERC implementation behavior. Commitment often works against implementation although in some instances, such as commitment to a policy arising out of a previous court order (Btu refunds and open access transportation), it had positive effects. The negative effects of commitment on implementation contributed to FERC evasion or narrow interpretation of the adverse court order in three of the cases. Removing agency view of the court from the analysis shows the importance of this particular variable in keeping the FERC at the implementation end of the scale especially when not only commitment but also external pressure and disruptiveness were negative forces.
CHAPTER 5

CONCLUSIONS

This chapter contains discussion of various topics growing out of the analysis and findings of the previous chapters including further treatment of the role of the courts in the policymaking of the FERC, judicial impact, subsystem politics, congressional oversight/dominance, and research issues such as difficulties with data collection and variable redefinition.

Subsystems and Implementation

As stated at the beginning of Chapter 1, the contribution of this particular research effort is the broader perspective that it takes on the judicial implementation process. Scholars proposing models of implementation have noted the importance of environmental factors in implementor decision making. However, studies of the implementation of judicial decisions by administrative agencies have concentrated traditionally on the implementing agency itself, excluding the outside forces in fashioning their explanations of whether the court orders have been faithfully implemented or evaded. More recent studies of judicial
implementation have taken the broader approach by examining the environmental factors as well.¹

This research presents a good case study of how judicial policies are implemented in a subsystem environment and is in line with the frameworks of various authors described in Chapter 1 including Ripley and Franklin, Heclo, Meier, Sabatier, and Berry. Natural gas policy evolves in a subsystem marked by controlled conflict. Litigation is an important part of that conflict as organized economic interests vie against each other (in court and in agency proceedings) and with the regulatory agency (in court) for influence on policy. The agency, the FERC, is an important actor in the subsystem and is not just a passive recipient of outside influence.²

In short, the results of this research show the need for asking both of the questions guiding this effort. How the agency actually responded to the disturbance of the court order is crucial to understanding the policy process. But the role of the outsiders in influencing that response


² A former FERC Chair noted in an interview that the Commission has a history of independence dating back to its previous life as the Federal Power Commission. This history helped shape its interaction with the various forces in its environment including the Reagan administration. This research shows that the FERC can be fairly independent of the outsiders in its environment. Industry representatives commented more than once in interviews for this research that no one segment of the gas industry held sway at the Commission.
is just as important to a complete understanding of the process. Concentrating on the agency exclusively particularly in a subsystem context could reflect the so-called "top-down" bias of implementation studies. The court or the agency issues orders and others in the subsystem are expected to obey. This research shows that such behavior does occur repeatedly. However, it does not occur exclusively in this controversial regulatory policy area. Policymaking is frequently more lateral than top-down. Outside interests have some say in shaping policy through rulemaking as mandated by the Administrative Procedure Act and through litigation. Thus both questions asked at the outset of this research should be addressed for a more realistic examination of policy. Research might need to be more limited, covering fewer agencies or programs, but focused on the external portions of the subsystem as well as on the agency.

The natural gas policymaking environment is characterized by advocacy coalitions as described by Sabatier, Berry, and others. Membership in those coalitions may change within the same case as the issue of contention changes. These arrangements are not cast in stone and represent mainly agreement on the issues involved in a case rather than any formal agreement to cooperate long-term.

Litigation can be part of the implementation of policies. The conflictual subsystem context characterized by litigation does result in policy redesign and evolution, two facets of implementation discussed in

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3 According to scholars making this argument, many researchers assume in their studies that only the views and objectives of those at the top of an organization or bureaucracy are legitimate and that any deviation from those goals is wrong. Clear statements of goals, fewer such goals, and less complex organizational structures are recommended as means of avoiding implementation problems. As Dennis Palumbo notes, the top-down approach ignores the multiorganizational environment in which policies are implemented. See Dennis J. Palumbo, "Introduction," Policy Studies Review 7 (Autumn 1987): 91-102 at 93.
the literature. While scholars concentrated on agency officials in describing evolution and to a lesser extent redesign, this research shows that the judicial process including litigation and the courts are also important facets of policy evolution. Litigation and the resulting court mandates might stop redesign and evolution or aid it. Litigation is part of the normal business routine of the natural gas policy subsystem, a way to try to influence the policy agenda when other methods have failed, and thus a way to prod policymakers.

A Related Point

Another important implication of the research findings concerns democracy and the concepts of congressional dominance and principal/agent. The Commission operated fairly independently in these five cases. A House staff member remarked that the Congress appeared to be content with Commission gas policy at this time and the legislative branch was active in only one of the five cases. The White House also left the FERC free to chart its course after shaping its membership through appointments. It does not appear that many fire alarms were sounded (except for certain parts of Order No. 436) and thus oversight was more limited although not nonexistent.

This was perhaps the manner in which the system was intended to work. The Commission handles the difficult technical details of energy regulation, making decisions that have important consequences for the country. The Congress and the White House intervene only as necessary through appointments and occasional oversight. Because the issues are technical and controversial, intervention may not occur too frequently. Alarms may sound but most will be handled by administrative and judicial processes. Thus the delegation of authority, its design, and the limitations on that delegation, as discussed by principal/agent frameworks, are
crucial. The Commission may operate for the most part out of sight but its anticipatory submission to its principals, the subtle signals sent by principals in the executive and legislative branches, and of course judicial supervision provide limitations on the exercise of its power.

The Role of the Courts

The courts are important factors in the Commission's natural gas policymaking. One criticism leveled at the ability of the judiciary to shape policy in any area is that it is a passive branch of government. Courts have to wait for some other party (i.e. litigants) to summon them before they can take action unlike the executive and legislative branches which can act on their own initiatives. It can safely be said that the courts have been summoned with sufficient frequency in the natural gas arena to enable them to have some major effect.

The involvement of the courts in natural gas policy can be attributed at least partly to the major economic interests involved. As seen at various times in previous chapters, the industry is not united and the different segments are often at odds. Former FERC Commissioner Charles Stalon observed that Commission policies involving a major transfer of wealth will almost inevitably result in action by the courts and Congress instigated by the interests faced with the loss of wealth. A

4 See Charles G. Stalon, "Pipeline Open Access and the Deregulation of Natural Gas Production," paper presented at the American Enterprise Institute Conference on Policy Approaches to the Deregulation of Network Industries, Washington, D.C., October 10-11, 1990, pp. 36-37. The INGAA case with its shuffling of $1 billion between the various segments of the industry and the take-or-pay controversy involving many more billions of dollars are two examples of large wealth transfers referred to in this research.
former FERC Chair, interviewed for this research, made a similar observation. The large amounts of money involved in gas regulation, the many issues, and the fact that someone's interests would be harmed or substantially affected by a Commission action will result in litigation and thus judicial involvement.

There appear to be four main roles or functions performed by the judiciary with respect to the Commission and the industry in these cases: interpretory, prodding, affirming, and referee. The interpretory function, the basic constitutional duty that one would expect the courts to perform, involves interpretation of the major statutes under which the FERC operates and decisions on whether specific actions of the Commission are in accord with those laws. This was seen, for example, in Mid-Louisiana, INGAA, and Northern Natural where the courts found that Commission orders went against the Natural Gas Act, the Natural Gas Policy Act, or court precedent.

The prodding and affirming functions may be performed in conjunction. When the court prods the Commission, it is basically telling the agency to reconsider and/or reformulate a policy, fixing defects that the judges have found. This was seen mainly in Maryland People's Counsel and Consolidated Edison. Courts perform the affirming function, demonstrated in Associated Gas Distributors and in the second INGAA decision (where the judges agreed with the Commission's refund order and its initial refusal to use the offset), when they agree with and perhaps compliment the Commission on a policy. In some instances the policy may have been implemented originally as a response to a court order as in the INGAA case and to some extent in AGD.

The referee function is another basic function that courts perform in society at large. In the case of this research, it means that the judges had to settle a dispute involving the various segments of the gas industry.
The entire INGAA litigation pitting the different sectors against each other first at the FERC and then in the courts is a good illustration of this function.\(^5\)

The interpretory and referee functions are fundamental exercises of judicial power and are really at the core of judicial legitimacy. Society looks to the courts to mediate disputes and interpret the laws. With respect to interpretation in the Mid-Louisiana and INGAA cases, the judges found that Commission policy went against provisions of the Natural Gas Policy Act and had to be overturned. The Commission obeyed although somewhat hesitantly at first in the Mid-La case. The Northern Natural case also was an instance of interpretation with the FERC defying an old precedent in an attempt to persuade the court to revise it. Overall, it appears that the FERC is willing to defer to the courts but there is occasionally some resistance.

The court performed the referee function in the INGAA case by ruling in favor of pipelines over producers. In this instance, the FERC lost because it had sided with one segment over another and it proceeded to implement a refund program in which it basically shifted sides in the controversy.

The prodding and affirming functions are probably the more interesting in terms of the court-FERC relationship in these five cases. As shown in both the INGAA and MPC/AGD cases, the courts overturned FERC programs, nudging the Commission to move in directions

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\(^5\) The separation of these functions in this discussion is somewhat artificial. Statutory interpretation is a basic duty of the courts and is present in all five cases. A court may prod and affirm through its use of interpretation. The referee function is also present to some degree in all five although the INGAA case is probably the best instance of it. As with many social science characterizations, this discussion is intended to shed some light on what is going on but at the same time there is some gloss over other parts of the reality.
that in one instance \((MPC/AGD)\) it already was headed but that in the other \((INGAA)\) caused a fair amount of pain in the industry. It was in performing these functions that the courts appeared to have the most impact on FERC policy in these cases. In \(MPC\), the court overturned old transportation programs that the Commission would have had to replace fairly soon anyway. The court then gave its blessing to the new direction in which the FERC was headed in the \(AGD\) ruling. As shown in interviews conducted for this research, the main effect of the rulings might have been in silencing the internal critics of the moves that the Commission was making. In short, the court actually strengthened the institutional agency commitment to its new policy initiatives. In \(AGD\) also, the court prodded the FERC to take some action on the take-or-pay problem and the next order in the Commission's transportation program resulted. In \(Consolidated Edison\), the court affirmed the Commission's new abandonment view that the needs of the entire market could be considered while also prodding the Commission to take action on take-or-pay.

Thus, it is clear that the courts can have some influence on Commission policy through prodding and affirming. However, it is also important not to overstate the courts' effects on policy. For example, an assistant to Commissioner Stalon stated that the Commission had moved rapidly in restructuring the industry and the courts "have not kept pace." The \(Maryland People's Counsel\) decisions had played a role in the implementation of Order No. 436 and the \(Consolidated Edison\) decision had played a role in the implementation of Order No. 490. But "by and large the Commission is out running ahead of the court." The \(Associated Gas Distributors\) decision had upheld policies that the Commission had promulgated almost two years earlier. Thus, the courts "can be helpful and they can be harmful but by and large they have not stopped the process." The courts had had an impact but they had not
stopped the Commission. The Commission had responded to the take-or-pay concerns of the courts in Order No. 500 and had moved on.

The *Associated Gas Distributors* ruling was a "vindication" of what the FERC had done as was the *Consolidated Edison* ruling. In responding to *AGD* and *Consolidated Edison*, the Commission had not turned back from its initiatives in transportation and abandonment. Stalon's assistant felt that the FERC considered those policies to be more vital than dealing with take-or-pay. The Commission had moved to deal with take-or-pay when prodded by the court in order to avoid jeopardizing those broader programs.

The relationship between the FERC and the courts is much more complicated than simply saying that the judiciary pushes the agency in certain directions and the agency accordingly responds. The courts can overturn and affirm Commission policy, bolstering Commission support for what it wants to do, or forcing the agency to discard a new initiative or even a longstanding policy. However, agency commitment is a powerful force and can be a check on judicial influence. The substances of the policies and court rulings are naturally very decisive factors here. In the cases of *Mid-Louisiana* and *INGAA*, the rulings were fairly black and white. The Commission had interpreted the statute incorrectly and had to stop doing what it had undertaken. Thus, there was probably no

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*The point should be made that in its implementation of the court orders in these five cases, the Commission was very deferential to the judiciary. Admittedly the FERC did take the easy way out at times when that was available. But as also seen at times in previous chapters, the Commission or some of its members did worry about adverse judicial rulings or whether the agency was carrying out a judicial mandate sufficiently. An example would be in the *INGAA* case during the debate over the offset mechanism at the Commissioners' meeting. The Commission approved the use of the offset in a divided vote with those opposing it arguing that the FERC would not be faithfully implementing the court's order.*

411
middle course for the FERC to pursue. The same can be said of *Northern Natural*.

On the other hand, FERC commitment to its new course in Order No. 436 meant that the *MPC* rulings actually helped that rulemaking to proceed and thus were not really disruptive. In the *AGD* and *Con Ed* cases the Commission was able to reinstate policies to which it was committed and move on. These latter two rulings were not painful for the FERC as the courts had been basically supportive while pointing out parts of the Commission policies that needed to be modified.8

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7 Although a former member of the FERC observed that the *MPC* decisions would have been much more disruptive for the Commission if it had not embarked on the Order No. 436 rulemaking by that time.

8 An interesting topic for future research might be the extent to which the courts stifle (or conversely, encourage) agency creativity. As noted in Chapter 3, the court recognized that the *Panhandle* ruling might result in the FERC having to reject innovative certification proposals. A representative of the Natural Gas Supply Association commented that the FERC had problems in court because it attempted to be innovative in promoting market forces in the gas industry. In the five cases under study here, the Commission did have trouble when it tried something new or technically superior. These included the dry rule, the special marketing programs, and contract demand reduction. This is not to say that courts should approve policies because they are new or innovative and probably few would argue in favor of blatantly discriminatory programs such as the SMPs. Agencies certainly need to conduct only legally valid experiments. The judicial reversal of a legally invalid experiment should hopefully lead to the promulgation of a better program.
Judicial Impact

Some of the points about the role of the courts and litigation made above can be used as a base for this discussion on judicial impact. There is a debate in the literature on whether and to what extent the courts can have impact on policy and on society at large. Rosenberg has taken the more pessimistic view, arguing that the courts (and specifically the Supreme Court) are seriously constrained when they undertake initiatives such as school desegregation intended to foster major social and cultural change. Only when other forces, such as political or economic elites or the market, embrace or otherwise work toward the same objectives can judicial goals be attained. In the case of school desegregation, Congressional approval of federal funds for local school districts (and the ability of federal judges to shut off those funds) plus a change in the view of southern business leaders did more for integration than did the Supreme Court decision in Brown. In the case of abortion, it was the availability of a market alternative to resistant hospitals, the abortion clinics, that enabled the Roe decision to have any impact. The courts

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9 A definition should be provided at the outset of this discussion. Canon has distinguished between compliance, implementation, and impact as the three broad categories of a judicial decision's consequences. Research on compliance is concerned with whether lower courts and officials abide by the decision. Compliance is a continuum rather than an either/or condition. Implementation research deals with the extent to which agencies and implementers take concrete steps to accomplish the goals of the court order. Impact encompasses the second-order consequences, the events in society that could be traced to a court decision or policy. Canon's diagram of the relationship of these three shows compliance then implementation then impact moving out in time and space from the decision. See Bradley C. Canon, "Courts and Policy: Compliance, Implementation, and Impact," in The American Courts: A Critical Assessment, eds. John B. Gates and Charles A. Johnson (Washington, DC: CQ Press, 1991), pp. 435-466 at 438-439.

413
cannot lead the forces of social change. Rather, they will be just another factor (just one and not the most important one) helping to promote it.\textsuperscript{10}

On the other hand, in his study of appellate court rulings on welfare programs Melnick contends that the courts can have significant impact. The courts established a new "policy status quo" by expanding welfare rights (in the cases of Aid to Families with Dependent Children, Food Stamps, and special education) and shifted the burden in Congress onto those who would overturn their decisions. The judges that he studied (lower federal judges) saw their task as "nudging statutes along their proper evolutionary course." Eventually, the public and elected officials would come along.\textsuperscript{11}

This overview of the arguments made by these two authors provides some insight into the notion of judicial impact and perhaps into what one should be considering in this area. If one looks for the courts to have profound effects on important social and cultural trends or forces (race relations, abortion rights, the roles of and relations between the sexes), one will almost certainly be disappointed particularly when the courts are facing stiff opposition from embedded decades or centuries old values. If one is somewhat more modest or realistic about one's expectations, looking instead for programmatic impact or statutory development, then one may find more impact. In the case of the present study, the latter perspective is more on target.

Baum has proposed viewing impact from an implementation perspective. Judges and agency officials are seen as policymakers charged with implementing court decisions. The "central question" for research


becomes how officials respond to an order which is considered as an action requested by a higher policymaking agency. An important point made by Baum is that oftentimes researchers have concentrated in their implementation and impact studies on court decisions requiring major changes and thus meeting greater resistance. The result is an unrepresentative and biased picture.\(^{12}\)

The points made by Baum and by Melnick, as well as findings by various studies of substantial federal agency obedience with federal court orders,\(^{13}\) are very germane for this discussion. When viewing the findings of this study, the legislative history of Chapter 2 might be recalled. The NGPA had been a bruising battle for Congress in 1977-78 and the legislators were not able to enact, despite various attempts, any additional natural gas legislation for several years thereafter. Congress, as shown in interviews, was also fairly happy with FERC programs. Litigation may thus have appeared to be the only way for some interests to affect policy at this time. The stage was thus set for judicial impact in this area of policy.


In reviewing the cases and the discussion above of the different roles that the courts played in them, one can see that the judiciary did have impact. However, in line with the points made by both Baum and Melnick, that impact was policy/programmatic and may appear at times to be trivial rather than an earth-shattering social or cultural transformation. In Mid-Louisiana, the FERC had to abandon a policy that the courts ruled was counter to the statute. Commission policy was corrected and some pipelines collected higher prices. In INGAA, another FERC policy was overturned in favor of an older policy. This case, however, also involved a substantial transfer of wealth that turned into a long drawn-out refund process. In MPC/AGD, the court freed the Commission from old transportation policies and enabled it to proceed with an innovative policy that was part of industry restructuring. Both the industry and FERC policy were evolving and the courts played a role. The Con Ed case was also part of that evolution in that the courts upheld a new market-based abandonment principle while remanding the policy for some corrections. In Northern Natural, the FERC was thwarted in its attempt to have the court remove a restriction on certification. The restriction (or impediment in the view of the Commission) on FERC procedures remained.

To return to the point made above about realistic expectations, these cases might seem trivial when compared with major historical

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One could perhaps argue, based on the history in Chapter 2, that the Supreme Court had had major impact on gas regulation. In 1954, the Court had ordered the FPC to regulate production. The Commission had attempted to do so over the course of the following two decades, pursuing individual then area then national rates. The results, to some observers, were depressed prices in the interstate market, diversion of gas to the intrastate market, shortages in the winter of 1976-77, and the drive to deregulation that led to the NGPA. This is just one flow of events and causality and others might be explored and argued. However, it is clear that the Court did have indirect impact.
events such as *Brown* or *Roe*. However, in the ebb and flow of the
development of an important area of policy and the national economy,
they are course corrections, refinements, and evolution. It is true, as one
interviewee remarked, that the FERC was out running ahead of the
courts and the courts did not stop the Commission from pursuing certain
of its initiatives. On the other hand, the courts were asked to approve or
disapprove policy and as a result they had a nuts-and-bolts type of policy
impact in these cases.

**Research Considerations**

This study raises a variety of questions concerning research meth­
ods. Some of these issues, such as variable specification, are touched on
in Chapter 1 but several issues need to be considered here at the conclu­
sion of this work. These include variable redefinition, difficulties of data
collection, and the unpredictability of this type of effort.

Variable redefinition was an interesting development that arose
during the course of the research. Two main instances involving agency
view of the court and disruptiveness of the court order occurred. Agency
view of the court was originally intended as a measure of whether the
FERC viewed the court as a friend or foe, help or hindrance in the
execution of its policies. A favorable view would lead the agency to
accord more legitimacy to the court opinions and thus correlate with
more faithful implementation. In actuality, the Commission appears to
have skipped a step in this hypothesized process and accords legitimacy
regardless of how it may see the court. The court is to be obeyed because
it is the court. There was some evasion or resistance in the form of
appeals and holding back from the full implications of some of the court
orders. However, there did not appear to be any determination (at least
none found by this research) that the court was a friend or foe. This is in
accord with Shapiro's notion of the judicial subordinate overseeing the agency subordinate. In addition, it is in accord with how we would want our system to work. We expect obedience to the law as interpreted by the court regardless of how we might feel about the judges or about their interpretation.

The second instance of variable redefinition concerns disruptiveness of the court order. Originally this was meant to measure the disruption for the agency and to be an indicator of the effect of the court order on the agency's program. More disruption is hypothesized to lead to less faithful implementation of the court order and less disruption to more faithful implementation. The research shows that this variable was reconfigured in many instances to mean disruptiveness for the industry or for the gas policy subsystem. In this form, the variable seems to have had more impact than it would have had. Disruptiveness of the court order led to external pressure in the *MPC/AGD* case, a finding that was not expected given the variable's original specification. This redefinition and unexpected findings show more clearly the workings of the subsystem and provide some interesting results than might have otherwise been the case.\(^{15}\)

\(^{15}\) A somewhat related point, although not redefinition so much as multiple definitions, involves the variable agency commitment. Agency commitment meant different things in the various cases under study. In other words, there was a variety of motivations for the Commission's commitment to its policies. In the *Maryland People's Counsel* and *Consolidated Edison* cases, commitment was mainly a reflection of the policy values of the commissioners. It represented a view that there should be greater competition in the gas industry and resulted in greater responses to the court than the judges had called for especially in *MPC*.

In *Mid-Louisiana* commitment resulted from a duty that the Commission felt that it had under the law to protect ratepayers from excessive rates and pipeline profits and to encourage production. After the Supreme Court ruled, commitment then became a duty to obey the (continued...)
Both of these just mentioned instances illustrate the unpredictability of this type of research. Trying to impose the variable specifications and theories found in the literature onto the real world does not always work as cleanly as might be hoped. These cases resulted in some interesting yet unexpected findings and they show the need to incorporate some flexibility in research and to be open to the possibility that changes will have to be made in the study framework as the work proceeds. Variable redefinition is part of that.

The difficulties of data collection should be addressed. The startup costs of this type of effort are substantial but not insurmountable. One needs to become immersed in a policy area, learning about the major governmental and nongovernmental actors and the main issues. In the case of natural gas regulation, the issues are mostly technical and economic. While economists and lawyers have staked out this policy area for themselves, political scientists can carve out areas of study and yield interesting results if they want to invest the time.

\[\text{\textsuperscript{15}(continued)}\]

Highest Court. In INGAA, commitment also resulted from a felt duty under the law to guarantee that fair prices were paid. This resulted in both the dry, as delivered, rule and then in the order to pay refunds. In Northern Natural, commitment to what the Commission believed its authority should be meant a gamble to try to remove an obstacle to that authority.

These different notions of what agency commitment meant do not appear to result in different levels of agency resistance to outsiders. For example, commitment in both Mid-Louisiana and INGAA was based on a sense of statutory duty however the FERC did give in to outside pressure in INGAA by approving the offset. Commitment in both MPC and Con Ed was based on a policy agenda but the FERC gave in to external pressure in the MPC case by backing away from some provisions of Order No. 436. What appears to be more important in explaining resistance to outsiders is not what commitment means but the level of outsider pressure (much greater and intense in INGAA than in Mid-Louisiana and in MPC than in Con Ed) and the need felt by the FERC to avoid greatly disrupting the operations of the industry.
A variety of data sources can be found. Public documents such as agency annual reports and rulemaking documents, congressional hearings, and court orders are invaluable for learning about the major issues. The trade press was also important. Luckily for the present effort, there is a newsletter devoted to the FERC that provided much information not available from other sources. Consultation with people who are involved in the policy area is another valuable source of information. This research benefitted greatly from the interaction of the author with the staff of a research center devoted to the study of regulatory issues.

Interviews are an important data source used here quite frequently. Interview subjects were very cooperative and willing to explain points in detail. This author used a conversational style for the personal interviews, going in with a list of open-ended questions for the interviewee's response. Personal interviews were tape recorded and notes were taken only occasionally. Notes were taken during telephone interviews although one such session was recorded. The main difficulty encountered in the interviews was arranging the sessions (personal and telephone) because of the busy schedules of the subjects. Some sessions had to be cut short, but there was generally enough time to cover the points needed.

A few points should be made about the strengths and limitations of this type of research compared with a statistical study covering more agencies. That latter type of research has the advantage of comparability. Using probit or time series analysis to assess the effects of various stimuli on agency behavior allows the researcher to cover more agencies over a greater period of time. The results would appear to be more scientific, and more easily replicable than the results obtained here. One

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has the advantage of a cross-agency analysis and perspective and can consider more bureaucratic environments although probably not in as much detail.

The main advantage of the case study approach used here is that the researcher can bring out more of the richness of the decision making process and show the same set of actors reacting to different stimuli under different conditions. The historical narrative has the advantage of depth while the statistical approach has the advantage of breadth. The two approaches should be complementary and should not be set in opposition to each other.

It is felt that this work has shown how worthwhile immersion in an important area of policy can be for a better understanding of the impact of the courts and other governmental and nongovernmental actors on the nation. Concentrating on not just the agency involved but also on the significant others of the policy subsystem is necessary to result in more realistic findings on how the policy process works and on how adverse court rulings are implemented. This research examines court orders impacting on one policy subsystem involving one agency. Future efforts in the study of judicial implementation could examine other subsystems with other agencies or examine further the FERC and other areas of its jurisdiction. However, it is believed that only by addressing both questions guiding this study and looking at both the agency and its environment can a truer picture of the process be sketched.
APPENDIX

NATURAL GAS AND FERC-RELATED ACRONYMS AND ABBREVIATIONS USED IN THE STUDY

AGA-American Gas Association
AGD-Associated Gas Distributors
AIC-Additional Incentive Charge
Btu-British Thermal Unit
CD-Contract demand
C/LEC-Citizen/Labor Energy Coalition
Con Ed-Consolidated Edison
DOE-Department of Energy
FERC-Federal Energy Regulatory Commission
FPC-Federal Power Commission
FPO-Flexible Pricing-Pipeline Option
INGAA-Interstate Natural Gas Association of America
LDC-Local distribution company
LVCS-Large Volume Contract Service
Mcf-Thousand cubic feet
Mid-La-Mid-Louisiana Gas Company
MMBtu-Million British Thermal Units
MPC-Maryland People's Counsel
NGA-Natural Gas Act
NGPA-Natural Gas Policy Act
NGSA-Natural Gas Supply Association

Table A.1: Natural gas and FERC-related acronyms and abbreviations used in the study.
Appendix (continued)

NOI-Notice of Inquiry
NOPR-Notice of Proposed Rulemaking
OGC-Office of the General Counsel
OPPR-Office of Pipeline and Producer Regulation
ORA-Office of Regulatory Analysis
PGC-Process Gas Consumers Group
PSC-Public Service Commission
SMP-Special marketing program
Tcf-Trillion cubic feet
Transco-Transcontinental Gas Pipe Line Corporation
WACOG-Weighted average cost of gas
A. SCHOLARLY ARTICLES AND BOOKS


**B. STATUTES**


**C. COURT CASES**


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433


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436


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453


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