Foster natural gas Report

.... FROM WASHINGTON

NO. 1586

. . . for week ended
September 18, 1986

CONTENTS

HIGHLIGHTS

Published weekly by Foster Associates, Inc., an economic consulting firm specializing in the governmental problems of energy industries – including natural gas – and other regulated businesses.

1101 - 17th Street, N.W.
Washington, D.C. 20036
(202)-296-2380

Senate Energy Committee Approves Nomination of Martha Hesse to FERC and James Allen Wampler to DOE Post Without Dispute

Senate confirmation of Martha Hesse to the FERC is imminent following approval of her nomination by the Senate Committee on Energy and Natural Resources on 9/17/86. Hesse's nomination to fill the vacancy left by former FERC chairman Raymond O'Connor was affirmed by voice vote in the Committee. There was no discussion. At the same time the Committee voted approval of James Allen Wampler named to become DOE's Assistant Secretary for Fossil Energy. Neither candidate appears likely to encounter opposition on the floor of the Senate where confirmation is expected at any time.

Assuming confirmation, Hesse (44) will be designated by the President to serve as Chairman of the FERC, replacing Acting Chairman Anthony Sousa. A Committee hearing, conducted 9/9/86, went smoothly for both Hesse and Wampler. Only Sen. Lowell Weicker (R-Conn.), among the few Committee members actually present, questioned Hesse and then only with respect to her views on Commission procedures relative to pending applications to construct the 356-mile Iroquois Pipeline project. (See Report No. 1585, pp1-2).

However, nine congressmen submitted numerous questions in writing to Hesse regarding her opinion on issues ranging from hydroelectric power projects to natural gas pipeline take-or-pay problems. In response to several inquiries on her views of the Commission's role in take-or-pay disputes, Hesse declined to support a specific course pending further study. She nevertheless promised Sen. Wendell Ford (D-Ky.) to seek to assure that the Commission's policies "keep pace with the competitive changes in energy markets and that the needs of the public and the industry for timely decisions are met." As in her prior statement to the Committee, Hesse reiterated that the Commission should be "extremely sensitive" to the time value of money in its decision-making.

Yet Hesse could not predict when the Commission will resolve the Order No. 436 backlog. To the extent practicable, she will seek Commission action on all major pipeline Order No. 436 filings no later than 1/1/87 when extended waivers of the contract demand reduction/conversion provisions expire. More generally, Hesse responded to Ford that the goals of Order No. 436 and mandatory carriage proposed in natural gas legislation supported by the Administration are not mutually exclusive. But, absent legislative changes, she will support implementation of Order No. 436 and its voluntary open access program consistent with the existing legal and statutory framework delegated to the Commission under the Natural Gas Act and the NGPA.

One of Hesse's "highest priorities" will be to pursue FERC regulation to restore the American drilling industry and domestic gas producers to a level of health and stability in order to develop new domestic gas reserves needed over the long run.

With respect to FERC fee structures, Hesse proposes to review the methodology of standardized filing fees, the ability of the Commission to grant exceptions to the filing fees "in order to prevent inequitable results," and the Commission's practices in granting such exceptions to small entities.

Hesse also views allegations of unfair Canadian competition for domestic gas markets by opponents of as-billed treatment for Canadian gas to be "extremely serious." Addressing concerns along this line expressed by Sen. Pete Domenici (R-N. Mex.), Hesse responded that, if confirmed, she would support an expedited review and decision by the Commission. "The FERC should not approve rate structures which establish unfair competitive advantages for one set of producers over another." Accordingly, she pledged "to seek rate structures which permit domestic and Canadian gas marketers to

compete fairly, especially in light of the Commission's obligation to assure overall rates that provide long-term reliable supplies of gas to U.S. consumers."

Responding to questions by Senator Frank Murkowski (R-Alaska), Hesse said the FERC lacks jurisdiction to approve or disapprove the export of natural gas. Rather, its statutory obligation is limited to approving the place of export (to the extent not previously approved by ERA) and to performing environmental review functions. Hesse promised to seek an expeditious resolution of any questions brought to the Commission with respect to the Trans Alaskan Gas System project (TAGS).

Sen. Gramm Intends to Push Energy Relief Bill Including Provisions to Facilitate Transportation and Use of Natural Gas

Senator Phil Gramm (R-Tex.) still appears determined to make a last try at winning Senate approval of limited natural gas legislation proposed as part of a package of provisions to bring relief to various segments of the oil and gas industry. Formal introduction of the long-anticipated bill could occur as early as either Friday or Monday. According to an aide to Sen. Gramm, finishing touches on the measure were being drafted throughout the week. Its ultimate prospects in the final days of this session of Congress remain uncertain.

Based on a summary of the bill's provisions drafted to date, Gramm will seek relief in three areas -- oil production, natural gas use and regulatory reform. The natural gas provisions purportedly "empower the (FERC) to mandate the transportation of natural gas without discrimination as to class of shipper or recipient;" prohibit "differential treatment" of pipeline rates for domestic and imported gas to ensure equitable allocation of cost components, and "thereby assuring that U.S. and Canadian gas sell on a competitive basis in interstate commerce;" permit a limited exemption to independent producer cooperatives allowing them to pool natural gas for sale; and repeal the gas and oil demand restraints imposed by the Fuel Use Act.

The oil provisions repeal the Windfall Profits Tax, restrict purchases of imports to fill the Strategic Petroleum Reserve, and call for thorough assessment of the economic and security impact of petroleum imports and current restrictions on exports of oilfield equipment and drilling technology.

Finally, the Gramm bill clarifies and facilitates changes in the regulation of solid waste disposal including restrictions imposed on underground storage tanks, and expresses the "sense of Congress" on several issues ranging from a reinterpretation of the use of permits issued under the Clean Water Act, recycling activities, land treatment sites for petroleum wastes, and full cost and accounting methods used by the oil and gas industry.

Panhandle Eastern Will Fight Revocation of LNG License and Restrictions Imposed on LNG Cost Recovery If House Bill Becomes Law

Officials of Panhandle Eastern Corp. promised to fight provisions in a House-passed bill (H.R. 4669) intended to revoke its license to import LNG from Algeria under a 1975 contract and to bar passthrough of costs associated with a recent settlement of the Trunkline LNG project. If such provisions were to become law, Panhandle said they "would represent an unconstitutional confiscation of property which the Company would vigorously challenge in all appropriate forums."

The bill, passed by voice vote on 9/9/86,[1] eliminates restrictions imposed by the Fuel Use Act on oil and gas use; repeals incremental pricing established under Title II of the NGPA; revokes FERC orders authorizing the importation of LNG; prohibits recovery in pipeline rates of payments made for LNG volumes never delivered, costs connected with ocean transportation of such volumes and costs related to equity investment in LNG facilities; requires review by the Secretary of the Department of Energy of future LNG import proposals; exempts Interstate Power Co., an electric and gas utility operating in Iowa, Illinois and Minnesota, from FERC regulation;[2] and sets a deadline of 1/31/87 for an FERC decision on a complaint by Central Illinois Light Co. (RP82-102-000) against a Panhandle tariff condition restricting its general service customer sales to those distributors which do not purchase gas from another pipeline.

As approved by the House Energy Committee in mid-August, H.R. 4669 was limited to repeal of FUA constraints on usage of oil and natural gas. The LNG provisions and other amendments were apparently added during the August recess. A surprise to Panhandle and others, the amendments were clearly devised to effectively revoke Panhandle's license to import Algerian LNG under a 1975 contract and to prohibit Panhandle from passing on to customers the costs of recently negotiated settlements with Sonatrach (the national oil and gas company of Algeria), and with General Dynamics Corp. and Moore McCormack Resources, Inc., to resolve claims stemming from suspension of imports by Trunkline LNG Co. in December 1983. The settlement with Sonatrach required Panhandle to make a cash payment of $200 million and issue 6 million shares of common stock (which Sonatrach can compel Panhandle to purchase at a price of $55/share after two years). The cost of the second settlement to Panhandle is $135 million. Together, the costs of the two settlements could exceed $660 million. (See REPORT NOS. 1578, pp5-6; 1582, pp1-2; 1585, pp1-2).

In a press release issued following the House vote, Panhandle contended that the legislation "is punitive and subverts the established regulatory process where all issues can and should be evaluated on their merits in an orderly manner in the interest of all parties legitimately involved." By revoking an otherwise properly issued import license, the company maintained, Congress raised serious questions about the reliability of Federal permits in international commerce involving "far more than trade in natural gas." Finally, Panhandle found it to be "equally disturbing that the sponsors of this legislation have included market-related pricing criteria for imported

---

[1] A member of the Senate Energy Committee Staff said recently that the House bill had been referred to the Energy Committee, but that it was unlikely the measure would be taken up by the Committee since Committee Chairman James McClure opposes further attempts to raise any natural gas issue "unless a consensus develops."

[2] On 7/24/86 the FERC issued a declaratory order asserting jurisdiction over transportation by Interstate Power (CP86-316-000) through a 26-mile segment from Hooppole, Illinois to Clinton, Iowa.

gas, which standards are already in place, while continuing to ignore constructive action on contract reform involving domestic production which carries substantially more significant economic impact for consumers and all segments of the gas industry."

One of the bill's sponsors, Rep. Robert Michel (R-Ill.), defended the LNG amendments, together with the CILCO deadline, in remarks submitted for the Congressional Record on 9/11/86. Michel said Panhandle alone must foot the approximately $660 million cost of what he contended is a "sweetheart" deal with Algeria. He alleged that Panhandle had increased the cost of gas to Midwestern ratepayers by more than $534 million compared to the cost of Texas and Louisiana production that was shut in during the period that Trunkline was taking Algerian gas. If costs of the settlement with Algeria were passed on to ratepayers within the one year period that Panhandle proposes, Michel contended his constituents in Peoria would have their natural gas bills increased by nearly 13%, "an unconscionable increase for an area already suffering economically." Michel stated that pipelines like Panhandle must learn to accept the responsibility for their management decisions in the new deregulated environment. Accordingly, the amendments ensure that Algerian LNG imports cannot be resumed unless they are price competitive, place the costs of the settlement recently negotiated by Panhandle "where they belong," and "avoid an additional cost to Midwestern ratepayers that would artificially discourage purchases of domestic gas."

To Michel, the sole supplier restrictions raised in the CILCO dispute are similarly inconsistent with deregulation of natural gas markets and a free marketplace. While Congress does not attempt to tell the Commission how to resolve the case, Michel indicated that a deadline for a decision is "the least we can require." Referring to four years of proceedings in which the Commission has allowed discovery, held hearings, provided four rounds of legal briefs, and received an initial decision by an administrative law judge, Michel said "it is simply ridiculous that the Commission should take this long to decide a case." Costs passed on to captive customers during this period of indecision have been enormous, he added.

Okla. Corp. Comm. appealed to CA 10 on 10/3/86

Federal District Court in Oklahoma Holds that Oklahoma Ratable Take Statute and Regulations Are Unconstitutional

On 9/4/86 the U.S. District Court for the Western District of Oklahoma (Judge Wayne E. Alley) issued a memorandum opinion declaring an Oklahoma ratable take statute (52 Okla. Stat. Sec. 240), along with certain related regulations adopted by the Oklahoma Corporation Commission (Rule 1-305), to be unconstitutional as applied to interstate pipeline purchasers. The opinion amplified Judge Alley's ruling from the bench on 5/12/86, following oral argument, which granted summary judgment in favor of nine interstate pipelines. ANR Pipeline Co. et al. v. The Corporation Commission of Oklahoma et al., No. CIV-85-1929-A et al.

Section 240 of the Oklahoma statutes requires ratable takes by common purchasers from each producer within reasonable reach of its system. By order dated 10/19/83, the Oklahoma Commission promulgated a new rule (1-305) establishing a priority schedule of takes in view of serious supply/demand imbalance problems which had arisen in the state. This rule, effective 1/1/84, required that first purchasers take gas according to the following priorities whenever production from a common source of supply exceeded reasonable market demand: (1) hardship and distress wells; (2) enhanced recovery wells; (3) wells producing casinghead and associated gas; and (4) assuming any further market demand, ratable takes from all allocated, special allocated and unallocated common sources of supply. Thereafter, in January 1984, the Oklahoma Commission initiated an inquiry to determine whether the ratable take statute and priority take rule were preempted by the U.S. Constitution and federal regulation of natural gas, and whether interstate pipelines had to comply with Rule 1-305. Following hearings, the Oklahoma Commission decided on 7/3/85 that it had jurisdiction to regulate takes of Oklahoma-produced gas as incidental to its responsibility to regulate production and conserve natural resources, and that such regulation was not unconstitutional or contrary to the federal regulatory scheme. The nine pipelines appealed to the U.S. District Court shortly thereafter. (See REPORT NO. 1529, pp9-11.)

Judge Alley held that Oklahoma's ratable take actions, insofar as they affected interstate pipelines, contravened the Supremacy Clause of the U.S. Constitution and were preempted by the federal regulatory scheme established by the Natural Gas Act and Natural Gas Policy Act. In support, Judge Alley relied on two U.S. Supreme Court decisions overturning attempts by other states to regulate purchases of natural gas by interstate pipelines. First, in Northern Natural Gas Co. v. State Corporation Commission of Kansas (372 U.S. 84 (1963)), the Supreme Court held a Kansas ratable take statute to be unconstitutional on federal supremacy and preemption grounds. Second, in Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi et al. (No. 84-1074, decided 1/22/86), a 5-4 majority of the Supreme Court invalidated a Mississippi Board order requiring ratable takes of NGPA-deregulated gas from all producers in a common pool. The majority ruled that the NGPA did not change the federal preemption doctrine underlying the Northern Natural decision, and that the Mississippi Board's ratable take requirement "directly undermines Congress' determination in enacting the NGPA that the supply, demand and price of high cost gas be determined by market forces."

The District Court said the Oklahoma actions at issue here, just as the Kansas statute and Mississippi rule, are intended to regulate takes of gas. Such regulation, however, allows individual states "to skew the free market for gas," thus contravening federal policy that gas market prices "be determined by the free flow of commerce on a national scale among the separate states."

Oklahoma's appeal, which was filed in the 10th U.S. Circuit Court of Appeals, reiterated the state's position that it has the right to regulate takes and priorities as part of its jurisdiction over production in Oklahoma. An official in the general counsel's office explained that the Mississippi and Kansas statutes "were directed toward purchasers." The circumstances are not the same in Oklahoma because the regulatory scheme there is producer-oriented, the appeal contended.

Judge Alley concluded that the Oklahoma statute (Section 240) and Rule 1-305 were unconstitutional because states may not impose requirements inconsistent with federal law. Secondly, despite recognition of correlative rights and conservation, the Oklahoma statute and rule -- similar to the Mississippi Board's action in Transco -- ". . . directly undermines Congress' determination that the supply, the demand and the price of high cost gas be determined by market forces." In short, Judge Alley declared, "the subject matter has been preempted by federal law, which, as Justice Rehnquist observed in footnote 3 of his dissent [in Transco], can occur either through an actual conflict of federal law or a Congressional intent to occupy a given field."

Missouri Attorney General Files Antitrust Suit in Federal District Court in Kansas Against Northwest Central, Amoco Production and CSG Exploration in Connection With 1981 Contract Amendments Covering Tight Sands Gas Purchases in Wyoming

In early August, the Attorney General of Missouri filed a complaint in the U.S. District Court for the District of Kansas against Northwest Central Pipeline Corp., Amoco Production Co., CSG Exploration Co. and certain producer partnerships. The complaint alleges violations of federal and state antitrust laws, fraud, breach of contract, and federal racketeering violations in connection with March 1981 contract amendments covering purchases and sales of tight formation gas in Wyoming. Filed by Missouri both on behalf of state agencies and political subdivisions and in a parens patriae capacity, the suit seeks unspecified damages, which are subject to trebling under the antitrust laws. The Missouri Attorney General estimates that damages could be found to exceed $40 million. State of Missouri v. Amoco Production Co. et al., Civil Action No. 86-2351-S.

Missouri's suit is similar to already pending complaints in the same court filed by the State of Kansas and Kansas Power & Light Co. The litigation also includes a complaint by The Gas Service Co. originally filed in the U.S. District Court for the Western District of Missouri in 1984 but subsequently transferred to the Northern District of Oklahoma and then again to the District of Kansas. The consolidated complaints are currently in the discovery stage.

The court actions complement FERC proceedings involving the March 1981 contract amendments. Last year, on 9/30/85, the Commission issued a declaratory order, in response to a petition by Northwest Central (GP84-56-000), ruling that the contract amendments satisfied the "negotiated contract price" requirement of regulations covering tight formation gas, and were effective retroactive to 7/16/79 as provided by the parties. The declaratory order also found that Northwest Central and the producer partnerships appeared not to be "affiliates" for purposes of NGPA Section 601(b)(1)(E), but reserved the right to reassess this and other questions upon conclusion of ongoing court proceedings. Finally, the Commission deferred certain fraud and abuse claims raised by Midwest Gas Users Association in a complaint against Northwest Central to the pending court cases. (See REPORT NO. 1538, pp32-34.)

The underlying factual situation is the same in the court and FERC proceedings. At issue are 13 contracts executed by Northwest Central with Amoco Production and Wamsutter Limited Partnership during 1977 and 1978 (prior to the NGPA) and 25 contracts executed with Amoco, Wamsutter and Moxa Limited Partnership during 1979 for purchases in Wyoming. The Wamsutter and Moxa Limited Partnerships both included CSG Exploration,

a subsidiary or affiliate of Northwest Central until late 1982, as a limited partner and Amoco as the general partner.[1] Each of Northwest Central's Wyoming contracts contained a "reserve life base" take-or-pay provision effectively requiring Northwest Central to take-or-pay for 90% of the deliverability of the wells. The contracts also contained "economic-out" clauses, but not exercisable for 10 years. By March 1981, about 53 wells subject to the 38 contracts were producing gas from tight formations, and Northwest Central was paying Section 102 or 103 prices for most of this gas.

Northwest Central and the three sellers then amended the contracts on 3/17/81 to include language permitting payment of applicable incentive prices for all deliveries of designated tight formation gas occurring on or after 7/16/79. The amendments were all signed for Northwest Central by Robert E. Berney who, at the time, was both a vice president of the pipeline and a vice president of CSG Exploration. Northwest Central thereafter paid the incentive price for tight formation gas retroactively from 7/16/79 to 3/17/81.

The Missouri complaint charged that the 3/17/81 contract amendments constituted "an unlawful price fixing conspiracy" and a per se violation of Section 1 of the Sherman Act. "But for the conspiracy intended to fix and inflate the price of natural gas," the complaint declared, Northwest Central had no incentive to amend its contracts and pay increased gas costs, now estimated to exceed $100 million. Hence, the amendments resulted from Northwest Central's desire to earn excessive profits for its affiliate, CSG Exploration, and for CSG's parent, Cities Service. Further, the complaint noted, Northwest Central had no need to encourage the production of additional tight formation gas in view of its ample reserves, and the pipeline received absolutely nothing in exchange for its agreement to pay the higher NGPA Section 107(c) price. The overall effect of the above actions, the complaint concluded, was to unreasonably restrain trade and foreclose competition among sellers or potential sellers of gas to Northwest Central. As noted, Missouri requested recovery of treble damages for the resultant overcharges.

Secondly, Missouri alleged fraud by reason of Northwest Central's representation of increased prices under the 3/17/81 amendments as legitimately incurred expenses, rather than as "kickbacks" paid to its affiliate without economic justification or necessity.

Third, Missouri contended that Northwest Central, by entering into the 3/17/81 amendments, "materially breached its common law and statutory duties of good faith and fair dealing in the performance of its contracts," thus causing damage by artificially raising the price of gas.

Finally, Missouri accused Northwest Central of violating the Racketeer Influenced and Corrupt Organizations Act (RICO) by using interstate mail and wire facilities to communicate "fraudulent misrepresentations."

---

[1] Northwest Central, successor-in-interest to Cities Service Gas Co., was a wholly-owned subsidiary of Cities Service Co. until 11/12/82 when it was sold to Northwest Energy Co. CSG Exploration was a wholly-owned subsidiary of Cities Service Gas until 6/1/80 when it was transferred to Cities Service Co., which was acquired by Occidental Petroleum Corp. in November 1982. In October 1983, Northwest Energy and Northwest Central were acquired by The Williams Companies.

Virginia State Corporation Commission Establishes General Guidelines to Govern Design of Industrial Sales and Transportation Rates

On 9/9/86 the Virginia State Corporation Commission (VSCC) issued a decision establishing general guidelines for designing industrial sales rates and transportation rates to be charged by utilities in Virginia. The decision culminates an investigation (PUE860024) initiated by the Virginia Commission last April. (See REPORT NO. 1564, pp32-33.)

At the outset, the Virginia Commission stressed the dramatic alteration in the traditional roles of interstate pipelines, intrastate pipelines and local distribution companies brought about by FERC Order No. 436. While the initial industry restructuring involves entities subject to FERC jurisdiction, local distribution companies must also adjust to the new way of doing business. Thus, "it is now incumbent on the local utilities and state regulators to make federal policies work for the public good."

The VSCC concluded that it is unnecessary to mandate transportation since most Virginia utility companies experiencing a demand for transportation have effective transportation tariffs on file. However, the Virginia Commission intends to encourage voluntary participation in transportation programs though such measures as taking account of load losses, resulting from a company's failure to transport, when setting rates.

With respect to transportation rate design, the Virginia Commission directed use of a fully distributed cost approach for both firm and interruptible service, applied on a company-by-company basis. Moreover, the VSCC noted, while interruptible service is inferior to firm service, it is nevertheless provided through the same facilities and hence should make some contribution for use of that capacity. Depending on customer mix and load profile, the Virginia Commission said that contribution will vary from company to company and therefore should be addressed on a company specific basis. To implement this overall transportation rate framework, the VSCC directed that all gas utilities in the state conduct and file cost of service studies within the next 12 months.

The Virginia Commission did not support flexible transportation rates. Unlike flexible retail rates, the VSCC explained, there is no readily identifiable alternate source of competition to transportation. "Transportation may occur due to any one of a number of factors ranging from wellhead cost of gas to alternate fuel prices. To respond to these variables, the utility would need to apply a different rate for each customer and would consequently engage in discriminatory ratemaking between similarly situated transportation customers. Such a framework would also result in problems with effective regulatory review problems."

By contrast, the Virginia Commission endorsed flexible rates for interruptible retail service as necessary to respond to the marketplace. The floor for such rates, the VSCC said, should generally be based on the highest commodity cost of gas or the weighted average commodity cost of gas where there is more than one supplier. However, a lower floor will be accepted if a utility can show

both that it is necessary to compete with alternate fuels and that firm customers will still benefit from retaining the interruptible sale. Since the point at which the price required to retain an interruptible sale no longer provides a benefit to the system will vary significantly from company to company, the VSCC said it is reasonable to start the floor at the highest commodity cost and then allow companies to prove a lower price is necessary and still beneficial on a case by case basis. "That test will of course reflect an analysis of several factors, foremost of which will be the incremental cost of gas acquired to serve the interruptible load."

The VSCC warned against a policy which would allow utilities to dedicate spot market purchases to their most elastic customers. Such an approach would not only result in inelastic customers improperly subsidizing elastic customers, the Virginia Commission said, but it would also eliminate one incentive for utilities to minimize general system costs. "With a low price necessary to compete with alternate fuels in the current market, a captive customer, or one with no ready alternative, might be assessed the higher cost of gas without close regulatory scrutiny."

In addition, the Virginia Commission determined that interruptible retail rates should include a customer charge reflecting the fully distributed costs of providing that service, and that firm industrial rates should be developed to move gradually towards a fully distributed cost of service. "At this point in the evolving competition in the gas industry, we concur with the recommendations of most parties that it is prudent to move toward parity of return in firm industrial rates. Such movement must be gradual to minimize rate shock to residential customers and carefully evaluated at each step."

With respect to other issues, the Virginia Commission favored unbundling of services for rate design purposes; declined to resolve legal issues regarding bypass because of an inadequate record; said standby service should be offered at compensatory rates; recognized the need for penalties under certain circumstances "to prevent gross abuses of system availability: but opposed penalties of an "onerous" nature which serve as a disincentive to transportation; and, citing the need for some assurance regarding the availability of upstream transportation capacity in order to encourage transportatiobn, passed on to the customers of Commonwealth Pipeline the company's allocation of Columbia's capacity for an interim period.

FERC Consolidates Panhandle Applications for Section 7(c) Transportation Authority with IPAMS Complaint Against Panhandle and Colorado Interstate; Orders Expedited Hearings to Explore Undue Discrimination, Marketing Affiliate and Bypass Issues

On 9/16/86 the FERC consolidated, and set for expedited hearing, (1) six pending applications by Panhandle Eastern Pipe Line Co. (CP86-232-000 et al) seeking Section 7(c) authority to transport ~~up to a total of 837,108 Mcf/d~~ on an interruptible basis for ~~135~~ high and low priority end users; and (2) a complaint filed 6/20/86 by the Independent Petroleum Association of Mountain States (CP86-584-000, CP86-663-000) against both Panhandle Eastern and Colorado Interstate Gas Co.[1] ~~The Panhandle~~ applications were protested by Michigan Consolidated Gas Co. which contended that they constituted an unduly discriminatory transportation program, among other things. The IPAMS complaint charged that "anticompetitive and unduly discriminatory actions" by Panhandle and CIG had effectively excluded IPAMS members from the two pipelines' respective market areas while at the same time enabling their marketing affiliates to gain a dominant position.

As a result of Order No. 436, the Commission noted that pipelines are feeling new economic pressures to adapt quickly to changing market conditions. Recognizing that these pressures may lead to corporate decisions which could adversely affect some competitors while promoting others, the Commission said it is seriously concerned about "~~just~~ what actions constitute legally acceptable behavior under the regulatory confines of the Natural Gas Act in this new market environment." The allegations by IPAMS and interveners in the various cases are sufficient to make a prima facie case and deserve the benefit of a full hearing on the merits, the Commission concluded: "In view of the evolving conditions in the marketing and transportation of natural gas, it is conceivable that there is some improper conduct by Panhandle and CIG, as alleged, either jointly or severally."

The expedited hearing will consider whether Panhandle's and CIG's transportation policies are unduly discriminatory, as well as issues relating to use of marketing affiliates and bypass. The Commission directed that an initial decision be issued within 90 days (by 12/15/86), and provided another 30 days for briefs on exceptions, ~~(15 days for initial briefs and 15 days for replies).~~

A prehearing conference is scheduled for 9/24/86.

Panhandle Applications

Five of Panhandle's six applications sought Section 7(c) authority to transport, on an interruptible basis (1) up to 67,000 Mcf/d for National Steel Corp. over a primary term ending 9/23/87, and year to year thereafter until 9/23/90 (CP86-232-000); (2) up to 55,000 Mcf/d for Archer Daniels Midland Co. over a term extending through 10/31/86 (CP86-486-000); (3) up to 3,000 Mcf/d for American Cyanamid Co. until the earlier of 6/5/88 or 30 days after Panhandle accepts a blanket certificate for open access transportation (CP86-551-000); (4) up to

---

[1] The complaint was filed by "Independent Producers Association of Mountain States" (IPAMS). However, IPAMS later made clear that its name is "Independent Petroleum Association of Mountain States." Also, the Commission recently assigned a separate docket number (CP86-663-000) to IPAMS' complaint against Colorado Interstate.

529,058 Mcf/d for 92 end users currently receiving Section 311 transportation service until the earlier of 6/30/87 or 30 days after Panhandle accepts a blanket transportation certificate (CP86-573-000); and (5) up to 3,000 Mcf/d for Kansas Industrial Energy Supply Co. (KIESCo), an unincorporated association of seven industrial end users of natural gas in the Wichita, Kansas area, until 6/25/88 or 30 days after Panhandle accepts of a blanket transportation certificate (CP86-598-000).

Panhandle's remaining application (CP86-504-000) asked to extend eight certificates issued 4/30/86 or 5/1/86, authorizing interruptible transportation of up to 182,650 Mcf/d through 6/30/86. (See REPORT NO. 1566, pp5-6.) Panhandle proposes to continue transportation of up to 180,050 Mcf/d for one year from the date of the original certificates or, if earlier, until acceptance of a blanket transportation certificate.

The above applications were all protested by Michigan Consolidated Noting that none of the applications proposed to transport gas on behalf of MichCon, the distributor alleged that Panhandle's transportation program, taken as a whole, is unduly discriminatory in preventing local distribution companies from obtaining transportation on terms similar to other shippers. MichCon further attacked Panhandle's applications as a de facto program designed to implement broad-scale transportation outside the terms and conditions of Order No. 436.

MichCon also raised bypass issues in protesting Panhandle's application to transport up to 67,000 Mcf/d for National Steel and directly interconnect with two National Steel plants located in MichCon's Detroit distribution area. MichCon argued that fundamental differences between pipelines and distributors prevent them from competing on equal terms, and that bypass of a distributor by a pipeline does not necessarily make sound policy sense "merely because the free market would appear to support bypass." MichCon said loss of National Steel as a customer would increase fixed charges to each of its one million customers by approximately $20 a year. Moreover, if Panhandle were to commence direct service to other industrial customers of Michcon in the Detroit area, this would shift about $75 million per year in fixed costs to the remaining MichCon system. Panhandle's proposed action thus does not represent an isolated, de minimis event, "but rather is likely the beginning of a large scale market penetration that would have large scale cost impacts for MichCon and its residential, commercial and industrial customers." (See REPORT NO. 1558, pp21-23.)

Mich Con charged

Panhandle denied charges of market raiding since MichCon's customers had all indicated a willingness to change suppliers. Panhandle also said it had offered all existing Section 311 customers an option to request the filing of Section 7(c) applications to continue existing transportation arrangements on the same terms and conditions. Since MichCon declined that option and instead proposed different terms, Panhandle claimed its refusal to accept those new terms was not undue discrimination.

IPAMS Complaint

IPAMS members own producing properties located adjacent to pipeline facilities of Panhandle and CIG, primarily in the Denver-Julesberg Basin. Some IPAMS members have gas sales agreements with Panhandle, which has requested release of the committed supplies.

The complaint contended that Panhandle had embarked on an anticompetitive and unduly discriminatory course of action as evidenced by (1) disruption of spot markets on its system by interrupting Section 311 self-implementing transportation service between November 1985 and April 1986, ~~(2)~~ delaying public announcement of resumption ~~resumed Section 311~~ transportation ~~in April~~ until its affiliate~~, Panhandle Trading,~~ had had ~~an opportunity~~ a chance to line up supplies and markets; ~~(3)~~ misquoting transportation tariffs to potential shippers, ~~(including IPAMS members) for nearly a month, thereby giving Panhandle Trading time to lock up markets and frustrating attempts of nonaffiliated producers to execute gas sales contracts with end users or LDCs on Panhandle's system; and (4) claims of~~ capacity constraints at various points on different dates. The success of this strategy has been "staggering," the complaint observed. Based on Panhandle's reports of Section 311 transportation filed with the Commission in May 1986, Panhandle Trading was involved in 81% of sales underlying this transportation. In sum, IPAMS declared, Panhandle's "deliberate disruption of the spot market for gas on its system impaired ~~access for~~ access to captive customers' access to cheaper supplies from independent sources ~~which were locked out of its markets,~~ and ~~also~~ allowed Panhandle Trading to establish a "dominant market position" in the spot market on Panhandle's system."

As to CIG, the complaint alleged anticompetitive actions mainly through its Section 4 rate filing (RP85-122) in March 1985. Among other things, that filing altered the definition of a "full requirements" customer from one taking at least 75% of annual requirements from CIG to one taking at least 75% of monthly requirements. The effect of this change, IPAMS explained, was to force such customers as Public Service Co. of Colorado to cut back cheaper purchases from independent suppliers during the summer months and instead to purchase more expensive system supply from CIG. Secondly, IPAMS noted, the same filing proposed a rate increase from 36¢ to 60.95¢ for onsystem transportation, nearly twice the proposed offsystem transportation rate of 32¢. Again, IPAMS said, the effect was to restrict access of alternate gas supplies to CIG's markets, since very few unaffiliated companies could take the risk that the "exorbitant" rate proposed for onsystem transportation might be ultimately affirmed by the Commission. But that same rate has paid off "handsomely" for CIG's marketing affiliate, Mountain Industrial Gas (MIG), which has been able to gain an 81% share of the self-implementing transportation volumes reported by CIG since issuance of Order No. 436.

IPAMS added that CIG's actions, by locking Denver-Julesberg Basin gas out of both the CIG and Panhandle market areas, "have also helped CIG's pipeline affiliate, ANR Pipeline Co., to avoid competing with the same supplies where its system overlaps the Panhandle market area."

Pending the outcome of an investigation, IPAMS asked the Commission, pursuant to NGA Sections 5 and 16, to (1) require both Panhandle and CIG to transport gas under Order No. 436 terms for all persons requesting such transportation; (2) in the event of refusal to transport under Order No. 436, prohibit blanket transportation of gas by Panhandle and CIG in transactions involving Panhandle Trading or MIG; (3) condition any individual Section 7(c) certificates sought by Panhandle or CIG to transport gas for Panhandle Trading or MIG, respectively, on nondiscriminatory, open access transportation for any person; (4) require Panhandle and CIG to transport gas for IPAMS members during the pendency of the requested investigation or until open access transportation is actually available; and (5) prohibit CIG from applying its currently effective definition of "full requirements customer" and from charging more than 32¢/Mcf for transportation to onsystem markets.

In replies to the complaint, Panhandle and CIG denied IPAMS allegations and asked the Commission either to dismiss the complaint or convene a hearing requiring the producers to document their charges. Panhandle also contended that IPAMS members may have violated federal antitrust laws by sharing market-sensitive information among competitors and by conspiring to bring market pressure upon Panhandle and restrain trade by Panhandle and its affiliates. Panhandle further requested that IPAMS' complaint against it be severed from IPAMS' complaint against CIG since transportation policies and actions of the two pipelines are entirely separate. (See REPORT NOS. 1574, pp18-19; 1580, pp30-32.)

FERC Order Directing Consolidation and Hearings

The FERC concluded that Panhandle's individual Section 7(c) applications and IPAMS' complaint should be consolidated since exploration of alleged undue discrimination "would be more meaningful if Panhandle's activities are viewed as a whole." Further, the Commission declined to sever IPAMS' complaint against CIG. While the complaint presents factually distinct issues as to Panhandle and CIG, the Commission noted, it also raises at least one common issue: whether there could have been an exchange agreement between Panhandle and CIG to transport gas for IPAMS' members. A related question is whether the lack of such an agreement was attributable to some covert agreement between Panhandle and CIG. The Commission said these questions can only be resolved if both Panhandle and CIG are available in the same hearing for cross-examination and rebuttal testimony.

With respect to IPAMS' complaint against CIG, however, the FERC deferred consideration of charges involving rates filed by CIG in RP85-122. Noting that this case is presently pending before it on exceptions to an initial decision issued 5/13/86, the Commission said a final decision may obviate some of the rate concerns raised in the complaint.

The Commission identified the following issues concerning Panhandle to be considered at the hearing: (1) whether Panhandle's transportation policies have been or currently are unduly discriminatory; (2) whether Panhandle's Section 7(c) applications demonstrate a pattern of undue discrimination by favoring a particular group of shippers, by treating similarly situated shippers differently, by favoring fuel-switchable end users or by denying shippers access to transportation in an unduly discriminatory manner; (3) whether Panhandle's application to transport gas for National Steel would bypass sales by MichCon, and whether the requested transportation authority should be granted giving consideration to the makeup of National Steel's fuel requirements, the availability of alternative sources of supply, and its choice of suppliers; (3) whether Panhandle's proposals would cause MichCon's customers to bear increased costs and to what extent, and whether any increased costs "would be borne by those customers in any event since National cites several proposals which it claims are more attractive financially than purchasing gas from MichCon"; (4) whether Panhandle (alone or jointly with CIG) has engaged in any anticompetitive behavior that is unduly discriminatory under the Natural Gas Act; and (5) whether Panhandle has used its marketing affiliate, Panhandle Trading, to monopolize spot market transactions on its system in an unduly discriminatory manner.

Regarding CIG, the Commission posed several of the same questions: (1) whether CIG's transportation policies have been or currently are unduly discriminatory by favoring a particular group of shippers, treating similarly situated shippers differently, favoring fuel-switchable end users, or denying shippers access to

transportation in an unduly discriminatory manner; (2) whether CIG (alone or jointly with Panhandle) has engaged in any anticompetitive behavior that is unduly discriminatory under the Natural Gas Act; and (3) whether CIG has used its marketing affiliate, Mountain Industrial Gas, to monopolize spot market transactions on its system in an unduly discriminatory manner under the Natural Gas Act.

Phillips and Transco Enter into New Contract for Offshore Gas at Lesser of Maximum Lawful Price or Market-Out Price, Subject to $1.50 Floor

Recently, Phillips Petroleum Co. (CI86-703-000) requested certificate authority to make sales to Transcontinental Gas Pipe Line Corp. from the West Cameron Block 480 Field, offshore Louisiana under a contract dated 8/20/86. The contract, which covers Section 104 gas (1973-1974 and post-1974 vintages), is one of very few to be filed with the FERC and publicly available in the last several months.

Phillips sold gas to Transco from the West Cameron Block 480 field under a previous contract dated 8/11/76. Regulatory authority to sell gas under this contract was said to have terminated effective 3/19/86.

The new contract provides for a one-year term beginning 8/1/86, continuing month to month thereafter until terminated by either party on written notice. If Phillips elects to terminate the contract, Transco will have an option and preferential right -- exercisable only once -- to transport the gas involved until depletion of the reserves.

The contract provides for a price equal to the lesser of the maximum lawful price or Transco's generally applicable market-out price, but not below $1.50/MMBtu. (Transco's market-out level has been at $1.50 or below for several months.) For determining the applicable maximum lawful price, it is specified that the contract shall not be considered a "rollover contract." The contract contains a so-called FERC-out clause allowing Transco to reduce the price to whatever level it is permitted by the FERC or other governmental authority to recover in its rates. In the event of a reduction, Phillips has 15 days to terminate the agreement provided it obtains a higher price from a third party purchaser. Transco has a preferential right to transport the gas if Phillips elects to terminate.

Transco is required to take or pay for 60% of Phillips' pro rata share of delivery capacity on an annual basis, but not more than 3,000 Mcf/d, plus all casinghead gas. A five-year makeup period is provided. If all deficiency volumes are not made up by the end of the five-year period (or, if earlier, upon cancellation of the agreement or depletion of the reserves), Phillips must pay Transco any still outstanding sums for unrecovered volumes.

The contract also specifies charges of 10.25¢/MMBtu per 100 miles for offshore transportation, and 3.10¢/MMBtu for onshore transportation of fuel, shrinkage and plant loss volumes resulting from processing of Phillips' gas, and a charge of $1.025/bbl. for transportation/handling of liquids.

FERC Dismisses Applications of Proposed Pipeline in Michigan as Beyond Its Jurisdiction Under Hinshaw Amendment to Natural Gas Act

On 9/16/86 the FERC dismissed applications of Washtenaw Pipeline Co. (CP86-444-000, CP86-445-000), a partnership comprised of wholly-owned subsidiaries of ANR Pipeline Co. and Consumers Power Co., requesting (1) a certificate to construct a 13.5-mile, 20-inch line interconnecting facilities of ANR in Washtenaw County, Michigan with facilities of Consumers Power in Wayne County, Michigan, and to transport up to 125,000 Mcf/day on a firm basis for Consumers Power through the new line; and (2) a blanket certificate for non-discriminatory transportation pursuant to Order No. 436. The Commission concluded that Washtenaw is a Hinshaw pipeline outside its jurisdiction under Section 1(c) of the Natural Gas Act.

Washtenaw's proposed interconnecting line was intended to provide Consumers Power with access to new sources of supply through ANR. At the present time, Consumers Power is served largely by Trunkline Gas Co. or by Panhandle Eastern Pipe Line Co. (indirectly through Michigan Gas Storage Co.) Except for certain deliveries through an emergency interconnection, Consumers Power currently receives no service from ANR.

The Washtenaw applications, filed 4/15/86, were protested by the Michigan PSC, Michigan Consolidated Gas Co., Panhandle and Trunkline. The Michigan PSC argued that Washtenaw would be a Hinshaw pipeline exempt from FERC jurisdiction under the Natural Gas Act because all gas would be received, transported and consumed within the state of Michigan, and because the company's rates and services would be subject to state regulation. In addition, the Michigan PSC and the other opposing parties contended that Washtenaw's proposed line would unnecessarily duplicate a 30-inch parallel line of MichCon which has sufficient capacity to transport the 125,000 MMcf/day bought by Consumers Power. MichCon indicated it would file a competing application to provide the service proposed by Washtenaw on a more economic basis. Panhandle and Trunkline expressed additional concerns about cost justification, environmental impact and adverse economic impact on their customers. Still another question was whether joint ownership of Washtenaw by a pipeline and a potential customer is anti-competitive. (See REPORT NOS. 1564, pp27-28; 1571, pp20-21.)

The FERC agreed with the Michigan PSC that Washtenaw is a Hinshaw pipeline beyond its jurisdiction under the Natural Gas Act. The facts are clear, the Commission said, that Washtenaw would receive all its gas within the state for ultimate consumption in the state, and that its rates and services would be regulated by the state PSC.

Moreover, the Commission noted, Washtenaw cannot opt to be a jurisdictional pipeline under the Natural Gas Act merely by filing a Section 7(c) application. Rejecting an argument by Consumers Power, the Commission said use of the word "shall" in Section 1(c) eliminates any option for Washtenaw to choose its jurisdictional status. The Courts have consistently held that intent of the parties is not determinative as to whether a particular facility is jurisdictional under the Natural Gas Act, the Commission added. In short, the FERC concluded, the Hinshaw exemption mandates exclusion from jurisdiction of any entity meeting the criteria set out in Section 1(c) of the Natural Gas Act.

FERC Directs Technical Conference on Northern Border's Application for Order No. 436 Blanket Transportation Certificate Subject to Waiver of Rate Design Requirements

By order dated 9/16/86, the FERC directed that an informal technical conference be convened within 45 days to explore several issues raised by an application of Northern Border Pipe Line Co. (CP86-395-000) for an Order No. 436 blanket transportation certificate. Northern Border's application, filed 3/19/86, was conditioned on waiver of various Order No. 436 rate requirements (Section 284.7 of the Regulations), especially the requirement to design transportation rates on the basis of projected units of service. Compliance with these requirements, Northern Border asserted, would fundamentally alter the terms under which construction of the pipeline was financed. The Commission said a technical conference would give Northern Border an opportunity to present additional information necessary to demonstrate its need for a waiver.[1]

Construction of the Northern Border line was certificated in 1980, as part of the "prebuild" portion of the Alaskan Natural Gas Transportation System (ANGTS), in order to transport up to 800,000 Mcf/d of Canadian gas imported by Northwest Alaskan Pipeline Co. (CP78-128 et al.) from Pan-Alberta Gas Co., Ltd. for resale to Eastern Leg shippers. Debt capital for construction was arranged on a project financed basis, which requires an assured stream of revenues generated from the project to service debt costs and cover operating expenses. To enable project financing, the Commission approved a cost of service tariff for transportation on Northern Border's system. Under this tariff (Rate Schedule T-1), Northern Border's annual cost of service is recovered through firm transportation rates paid by Eastern Leg shippers, irrespective of throughput levels. Revenues received from any other firm transportation, or from interruptible transportation, are credited by Northern Border to its cost of service.

Northern Border explained that, under a loan agreement dated 12/15/80, lenders may declare it in default if it seeks to change the terms of the original tariff or if the Commission orders tariff changes adversely affecting the company's ability to perform its loan obligation. In effect, the loan agreement bars subjecting Northern Border to any risk of underrecovery of fixed costs or reallocation of responsibility for cost recovery. Compliance with Order No. 436 rate requirements would therefore constitute an "event of default" under its loan agreement. Northern Border accordingly proposed a blanket certificate program which satisfies both the policies of Order No. 436 and the company's "unique tariff and financing arrangements."

Specifically, Northern Border proposed to offer self-implementing firm transportation service pursuant to the terms of its existing Rate Schedule T-1, which provides for fixed monthly charges designed to assure full cost recovery. To do so, Northern Border asked the Commission to waive requirements for use of volumetric, one-part rates designed to recover costs allocated to firm transportation on the basis of projected units of service. Regarding interruptible transportation service, Northern Border proposed to establish maximum and minimum rates under Rate Schedule IT-1, with the maximum rate subject to annual recalculation based on estimated cost of service and anticipated throughput. Revenues from both firm and interruptible self-implementing transportation service would be credited back to Northern Border's cost of service.

---

[1] Previously, on 7/29/86, the Commission ordered a technical conference on a blanket transportation certificate application by Ozark Gas Transmission System (CP86-250-000) which, like Northern Border, sought a waiver of Order No. 436 rate requirements on the ground that compliance therewith would necessitate major tariff modifications and hence trigger a default of the loan agreements behind the project financing. (See REPORT NO. 1581, pp15-16.)

In the event of curtailments, Northern Border proposed to schedule interruptions according to contract price. A party bidding a higher rate would receive a higher priority of service. In the event that two or more parties bid the same rate, Northern Border would interrupt service at that rate on a first-come, first-served basis. (See REPORT NO. 1562, pp23-24.)

Northwest Alaskan Pipeline Co., United and the Panhandle Producers and Royalty Owners Association (PPROA) protested Northern Border's application and requested evidentiary hearings. Northwest Alaskan and United subsequently withdrew their protests and now support the application. The PPROA was primarily concerned that grant of a blanket certificate would enable Northern Border to transport unlimited quantities of Canadian gas for an unlimited duration to the detriment of domestic producers.

The Commission concluded that Northern Border's application raised several issues requiring examination in a technical conference. These issues include:

(1) The need for a long-term waiver of Section 284.7 of the Regulations to avoid a default under Northern Border's loan agreements covering the initial financing of its pipeline. The Commission noted that Northern Border has been successful in the past in renegotiating terms of its loan agreements, and that its lenders might or might not be willing to consider an exception to permit design of rates for self-implementing transportation in accordance with Order No. 436 conditions. The record does not indicate, however, whether Northern Border has attempted to negotiate such an exception. Further, the Commission observed, Northern Border has not demonstrated conclusively that transportation rates for blanket certificate transactions, when designed in accordance with Section 284.7 of the Regulations, are at odds with its loan agreements.

(2) The appropriateness of a flexible rate for interruptible transportation service. The Commission also questioned whether Northern Border's proposed minimum rate of 1¢ per 100 dekatherm miles is sufficient to recover average variable costs associated with providing the service.

(3) Northern Border's ability to offer firm transportation to new shippers under Rate Schedule T-1 when the pipeline's entire capacity is currently under contract to Eastern Leg shippers. The Commission directed Northern Border to provide, at the technical conference, a separate tariff describing the terms and conditions for rendering firm transportation service under a blanket certificate.

(4) Northern Border's conditions for determining the "creditworthiness" of potential shippers under Rate Schedule IT-1. These conditions are presently undefined, the Commission noted, as well as the nature of any required documentation.

(5) The requirement that potential shippers under Rate Schedule IT-1 produce, on demand, copies of letters of intent with suppliers and with any upstream or downstream transporters. The Commission said this requirement may be overly broad and inhibit flexibility needed by interruptible shippers or, on the other hand, may be necessary to avoid oversubscription on Northern Border's pipeline.

(6) The curtailment priorities assigned interruptible shippers under Rate Schedule IT-1. Northern Border's proposal may be a form of capacity allocation by auction which was rejected in Order No. 436, the Commission noted.

(7) Whether Northern Border's proposal will have any anti-competitive effects.

Certain costs be allocated to interr. FTD service, including costs now recovered through Trailblazers demand charge,

Trailblazer and Western Transmission Seek Order No. 436 Blanket Certificates for Open Access Transportation

Applications for Order No. 436 blanket transportation certificates were filed by Trailblazer Pipeline Co. (CP86-720-000) on 9/12/86 and by Western Transmission Corp. (CP86-717-000) on 9/11/86.

Trailblazer -- a project-financed pipeline extending 436 miles eastward from a point of interconnection with Wyoming Interstate Co. near Rockport, Colorado to points of interconnection with Northern Natural Gas Co. and Natural Gas Pipeline Co. of America near Beatrice, Nebraska[1] -- requested waiver of certain Order No. 436 rate provisions (contained in Section 284.7 of the Regulations) requiring that interruptible transportation rates be based on costs allocated to that service. Trailblazer said it could not comply with that provision without being in default of its loan agreement, which requires a monthly demand charge adequate to recover operating expenses and debt service. The loan agreement specifies that any material modification to Trailblazer's tariff, certificates or FERC Opinion No. 138 (authorizing construction and operation of the Trailblazer System) will constitute an event of default, Trailblazer moved.

Accordingly, instead of allocating costs to interruptible service, Trailblazer asked permission to charge a 100% load factor rate as a maximum rate for interruptible transportation, with the demand component of this rate to be credited to firm shippers. The crediting mechanism would prevent double collection of demand related costs, Trailblazer said. The company declared that the requested rate design is within the spirit of Order No. 436 and satisfies the requirement that interruptible transportation rates be developed on a fully allocated basis. If the proposed waiver is approved, Trailblazer said it would otherwise operate in a manner consistent with Order No. 436.

Trailblazer is the third project - financed pipeline to seek a waiver of Order No. 436 rate requirements because of the risk that any change in present cost recovery through demand charges would trigger default of underlying loan agreements. The other two pipelines are Ozark Gas Transmission System (CP86-250-000) and Northern Border Pipeline Co. (CP86-395-000). In each case, the FERC found insufficient evidence in the record to justify a waiver and ordered technical conferences to give the pipelines involved an opportunity to present additional material in support of their requests. (See REPORT NO. 1581, pp15-16 and elsewhere in this REPORT).

Pending Commission review of its entire application, Trailblazer requested a temporary certificate authorizing blanket interruptible transportation on an interim basis. Trailblazer said temporary authorization would prevent disruption of service to Tennessee Gas Pipeline Co., currently its sole interruptible customer, and permit greater utilization of its system while the Commission is evaluating the company's open access plan.

Trailblazer would establish Rate Schedule ITS for interruptible transportation service and Rate Schedule FTS for firm transportation service, both available on a first-come/first-served basis to shippers meeting requisite qualifications. Interruptible

---

[1] Trailblazer Pipeline is the easternmost segment of the overall Trailblazer System (CP79-80 et al) extending 800 miles from southwestern Wyoming to Beatrice, Nebraska. The project was authorized by Opinion No. 138, issued 3/12/82, to enable attachment of gas supplies in the Overthrust Belt and other Rocky Mountain areas by Columbia Gas Transmission Corp., Colorado Interstate Gas Co., Natural Gas Pipeline Co. of America and Northern Natural Gas Co.

transportation would be subordinate in priority to service under firm transportation rate schedules (and best efforts transportation under arrangements currently in effect or pending authorization) but equal in priority to overrun service under those rate schedules. In the event that nominations for firm transportation service exceeded capacity and would require a system expansion, existing shippers would be given an opportunity to voluntarily reduce their contract demands to the extent necessary to accommodate the requested nominations.

The currently proposed maximum rate under Rate Schedule ITS is 66.60¢ which, as noted, represents the fully allocated maximum rate under Rate Schedule FTS (which includes a reservation charge of $10.42, a base interest component of $5.96 and a commodity charge of 32.34¢). The proposed minimum rate under both rate schedules is 1¢.

Western Transmission, which owns a gas gathering system in Wyoming, renders sales and transportation services under commodity-only rates. It proposes firm open access transportation under Rate Schedule OAT-1 and interruptible open access transportation under Rate Schedule OAT-2. The maximum rate under both rate schedules would be 12.6¢/Mcf. The proposed minimum rate is also the same (1¢/Mcf).

EIA Estimates Two Percent Drop in Proved Natural Gas Reserves in 1985 and 18 Percent Fall in Discoveries

In early September, the Energy Information Administration (Office of Oil and Gas) released an advance summary report estimating U.S. proved reserves of crude oil, natural gas and natural gas liquids as of 12/31/85. The report estimated total U.S. natural gas reserves at 193,369 Bcf, down 2.1% from 1984; total crude oil reserves at 28,416 million barrels, virtually the same as last year; and total natural gas liquid reserves at 7,944 million barrels, up 3.9% from the previous year.

The above report is the ninth prepared by EIA on U.S. reserves of crude oil, natural gas and natural gas liquids. The EIA reserve estimates are developed from operator responses to Form EIA-23 ("Annual Survey of Domestic Oil and Gas Reserves") and Form EIA-64A ("Annual Report of the Origin of Natural Gas Liquids Production"). EIA said the estimates are associated with sampling errors of less than 1% at a 95% confidence limit.

With respect to natural gas reserves, EIA observed that total proved reserves, total discoveries and new field discoveries in 1985 reached the lowest level since 1976 (the year EIA began to estimate reserves). The ratio of total discoveries to production in 1985 (70%) was also lower than in any year since 1976.

For the total U.S., the R/P ratio at the end of 1985 was 12.1 years. While this represented an improvement from the 11.5-year R/P ratio at the end of 1984, the change was due entirely to a substantial drop in production during 1985 (about 7%). Excluding Alaska (with proved reserves of 33,847 Bcf and production of 312 Bcf in 1985), the R/P ratio for the Lower 48 States was 10.2 years in 1985, compared with 9.7 years at the end of 1984.[1]

---

[1] In estimating Alaskan natural gas reserves, EIA did not reflect a large downward revision to North Slope proved reserves reported by Atlantic Richfield Co. during 1985. EIA said these volumes continue to meet its definition of proved reserves.

EIA estimates of proved (dry) natural gas and crude oil reserves are shown below since 1977, the year EIA commenced to make such estimates.

Total U.S.

R/P Ratio Excl Alaska		Revisions Increases	Revisions Decreases	Total Discoveries Extensions	Total Discoveries New Discoveries	Corrections and Adjustments	Proved Reserves as of 12/31	Production	R/P Ratio
Dry Natural Gas (Bcf)									
9.40	1977	13,691	15,296	8,129	6,474	(20)	207,413	18,843	11.01
9.47	1978	14,969	15,994	9,582	8,439	2,429	208,033	18,805	11.06
8.87	1979	16,410	16,629	8,950	5,754	(2,264)	200,997	19,257	10.44
8.96	1980	16,972	15,923	9,357	5,116	1,201	199,021	18,699	10.64
9.12	1981	16,412	13,813	10,491	6,729	1,627	201,730	18,737	10.76
9.65	1982	19,795	19,340	8,349	6,106	2,378	201,512	17,506	11.51
10.65	1983	17,602	17,617	6,909	4,539	3,090	200,247	15,788	12.68
9.66	1984	17,841	14,712	8,299	5,222	(2,241)	197,463	17,193	11.49
10.20	1985	18,775	16,304	7,169	3,959	(1,708)	193,369	15,985	12.09
Crude Oil (Million Barrels)									
	1977	1,503	1,117	496	298	(40)	31,780	2,862	
	1978	2,799	1,409	444	383	366	31,355	3,008	
	1979	2,438	2,001	424	212	337	29,810	2,955	
	1980	2,883	994	572	290	219	29,805	2,975	
	1981	2,151	880	750	411	138	29,426	2,949	
	1982	2,245	1,811	634	397	(83)	27,858	2,950	
	1983	2,810	1,299	629	295	462	27,735	3,020	
	1984	3,672	1,227	744	400	159	28,446	3,037	
	1985	3,037	1,439	742	253	429	28,416	3,052	

Proved natural gas reserves estimated by EIA over the past eight years by state are shown below. Of the seven states with the largest estimated reserves, only Wyoming reflected an increase during 1985.

Proved Natural Gas Reserves (Dry)
(Bcf)

State	1977	1978	1979	1980	1981	1982	1983	1984	1985
Alabama	530	514	652	636	648	648	785	961	821
Alaska	32,243	32,045	32,259	33,382	33,037	34,990	34,283	34,476	33,847
Arkansas	1,660	1,681	1,703	1,774	1,801	1,958	2,069	2,227	2,019
California	4,737	4,947	5,022	5,414	5,617	5,552	5,781	5,554	5,444
Colorado	2,512	2,765	2,608	2,922	2,961	3,314	3,148	2,943	2,881
Florida	151	119	77	84	69	64	49	65	55
Kansas	11,457	10,992	10,243	9,508	9,860	9,724	9,553	9,387	9,337
Kentucky	451	545	468	508	530	551	554	613	766
Louisiana	57,010	55,725	50,042	47,325	47,377	44,916	42,561	41,399	40,151
Michigan	1,386	1,422	1,204	1,406	1,118	1,084	1,219	1,112	985
Mississippi	1,437	1,635	1,504	1,769	2,035	1,796	1,596	1,491	1,360
Montana	887	926	825	1,287	1,321	847	896	802	857
New Mexico	12,000	12,688	13,724	13,287	13,870	12,418	11,676	11,364	10,900
New York	165	193	211	208	264	229	295	389	369
North Dakota	361	374	439	537	581	629	600	566	569
Ohio	495	684	1,479	1,699	965	1,141	2,030	1,541	1,331
Oklahoma	13,889	14,417	13,816	13,138	14,699	16,207	16,211	16,126	16,040
Pennsylvania	769	899	1,515	951	1,264	1,429	1,882	1,575	1,617
Texas	56,422	55,583	53,021	50,287	50,469	49,757	50,052	49,883	49,035
Utah	877	925	948	1,201	1,912	2,161	2,333	2,080	1,999
West Virginia	1,567	1,634	1,558	2,422	1,834	2,148	2,194	2,136	2,058
Wyoming	6,305	7,211	7,526	9,100	9,307	9,758	10,227	10,482	10,617
Miscellaneous a/	102	109	153	176	191	191	253	291	311
U.S. Total	207,413	208,033	200,997	199,021	201,730	201,512	200,247	197,463	193,369

a/ Includes Arizona, Illinois, Indiana, Maryland, Nebraska, Oregon, North Carolina, South Dakota, Tennessee, Virginia and Washington.

Northwest Central Proposes to Commence New Section 311 Transportation On Interim Basis, Subject to Waiver of CD Reduction/Conversion Requirements, Pending Approval of Settlement Offer

During early September, limited protests were filed to tariff sheets submitted by Northwest Central Pipeline Corp. (RP86-155-000) on 8/28/86 to enable it to commence new firm and interruptible transportation service under NGPA Section 311 on an interim basis pending Commission action on the company's recent settlement offer (RP86-32, RP86-68) to restructure sales and transportation services and offer open access transportation "consistent with the intent and purposes of Order No. 436."[1] In proposing this interim transportation, Northwest Central requested waiver of the Order No. 436 contract demand reduction/conversion requirement (Section 284.10 of the Commission's Regulations) and certain other waivers. The company sought an effective date of 9/27/86 for the interim transportation.

Northwest Central's settlement offer, filed 7/18/86, proposed to establish Rate Schedules FTS and ITS for nondiscriminatory firm and interruptible transportation consistent with Order No. 436; to provide a partial requirements sales service under a new Rate Schedule PR, available to two categories of resale customers, affording various options for reducing contract demand or converting to transportation; to offer standby sales service, in conjunction with transportation service under Rate Schedule FTS, to customers transporting gas released by the company; and to provide a new, interruptible deferred delivery service (or storage service) on an experimental basis for up to three years under Rate Schedule IDDS for shippers under Rate Schedules FTS and ITS. Along with the settlement offer, Northwest Central submitted two related certificate applications, one requesting blanket authorization to transport gas under Order No. 436 plus authorization to provide the proposed new sales, standby and deferred delivery services (CP86-631-000), and the other seeking limited-term blanket abandonment and sales authority necessary to permit Northwest Central's producer suppliers to market released gas subject to a pipeline right of recall and certain restrictions on Section 104 gas (CP86-630-000).

Unlike most major pipelines which have submitted Order No. 436 proposals, Northwest Central did not include a mechanism for recovering take-or-pay costs. However, the company proposed various measures to forestall loss of its lower cost Section 104 supply subject to abandonment under the Order No. 451 "good faith negotiation" procedure. One provision, for example, would permit Northwest Central to defer the effectiveness of the settlement unless it had been granted a right of first refusal, superior to any first refusal rights of its customers, as to any gas subject to abandonment under Order No. 451 based on a producer offer substantially accepted in principle by a new purchaser. This right of first refusal could be conferred either by a Commission order or by legally binding and effective contracts between Northwest Central and producer suppliers comprising at least 80% of the deliverability of gas reserves subject to abandonment under Order No. 451.

Northwest Central's settlement offer was supported by distributor customers and end users (including the Process Gas Consumers Group). The FERC Staff questioned restriction of standby service to customers transporting gas released by Northwest

---

[1] Since issuance of Order No. 436, Northwest Central has provided Section 311 transportation only under "grandfathered" arrangements.

Central, but otherwise did not oppose the settlement proposal. On the other hand, the proposal was protested by various producer interests, primarily because of Northwest Central's insistence on a right of first refusal to all gas subject to abandonment under Order No. 451. One or more producers also contested the proposed standby sales service and design of interruptible transportation rates. (See REPORT NOS. 1578, pp7-10; 1583, pp7-11.)

The tariff sheets submitted by Northwest Central on 8/28/86 would revise its presently effective Rate Schedule T-1 to reflect interruptible transportation rates and terms virtually identical to those included in the settlement offer (except that shippers would not be required to provide fuel and lost-and-unaccounted-for gas under the interim proposal). The terms of interim firm transportation proposed by Northwest Central also conform to the settlement offer.

Northwest Central asserted that its "unique" characteristics presented substantial barriers in implementing open access transportation. For example, Northwest Central noted, "full requirements" sales service has been provided in the past largely under end-use rate schedules (F-residential, C-commercial and I-industrial) without any specified limit on quantity and at one-part, volumetric rates. Thus, Northwest Central had no "partial requirements" rate schedule to accommodate the transition between sales and transportation services contemplated by Order No. 436. Nor did Northwest Central's full requirements contracts specify any firm sales entitlements or contract demand to provide a basis for implementing Order No. 436 reduction/conversion rights. Furthermore, Northwest Central's only transportation rate schedule (T-1) was not appropriate for transportation displacing sales service, and the currently effective T-1 rate of 7¢/Mcf per 100 miles for forward haul (1¢/Mcf per 100 miles for backhaul) was never designed to reflect a fully allocated transportation rate. Rather, the rate was negotiated as part of a settlement package which included a revenue crediting provision permitting Northwest Central to retain only 1¢/Mcf and requiring it to credit remaining transportation revenues to its sales customers through Account 191. Northwest Central said these historical obstacles prevented any straightforward application of Order No. 436 to its operations. Moreover, still another obstacle was recently presented by Order No. 451 (issued 6/6/86) which "jeopardizes Northwest Central's rights to approximately 76% of its gas reserves." Nevertheless, Northwest Central said it recently succeeded in developing a comprehensive program for open access transportation with the agreement of all parties.

Noting that Commission approval of its pending settlement may be delayed, Northwest Central contended that the ability to offer new Section 311 transportation would provide significant benefits to existing customers and other potential shippers by enabling purchase of lower priced spot market supplies and released system supplies. Such transportation would also help to alleviate pipeline take-or-pay liability. "Clearly, the policy objectives of Order No. 436 are more quickly achieved by permitting Northwest Central to offer interim transportation service under the proposed arrangement than maintaining the economic disincentives and regulatory barriers which have made new Section 311 services inaccessible to Northwest Central since October 1985." To commence interim transportation, Northwest Central requested waiver of the Order No. 436 contract demand reduction/conversion options, explaining that it is impossible to apply these options to the "unique" situation presented by the pipeline's full requirements contracts with no contract demand. Given its demonstrated willingness to participate in open access transportation, Northwest Central said

it should be allowed to defer implementation of CD reduction/conversion requirements pending action on its settlement offer.

Additionally, Northwest Central requested waiver of (1) the "full requirements" provisions of its F, C and I rate schedules and related service agreements to the extent necessary to assure that interim interruptible and firm transportation is available on a nondiscriminatory basis to existing sales customers, end users served by such customers and other potential shippers; and (2) revenue crediting provisions of a February 1984 settlement agreement (RP82-114) applicable to interruptible transportation provided under Rate Schedule T-1. Since the interim interruptible transportation now proposed under this rate schedule would extend to transportation which displacing sales, Northwest Central said continuation of the revenue crediting requirement would remove any economic incentive for it to provide this transportation.

Northwest Central further requested that the proposed interim transportation program not affect any first refusal rights available to it or its customers under Order No. 451 or any orders on rehearing. The Commission must also confirm that the interim transportation would not constitute open access transportation for the purpose of applying Order No. 451 regulations.

As noted, some limited protests were filed to Northwest Central's interim transportation request. Mesa Operating Limited Partnership objected to "postage-stamp" transportation rates which were said to conflict not only with Order No. 436 rate conditions but also with Northwest Central's traditional practice of mileage-based rates (per 100 miles). Mesa also contested establishment of interruptible transportation rates equal to firm transportation rates at 100% load factor. The Kansas State Corporation Commission and Midwest Gas Users Association protested the waiver of the revenue crediting provisions in the company's prior settlement (RP82-114). The Midwest Users said such waiver would deprive customers of the benefits currently obtained under the T-1 rate schedule without receiving in return the options and benefits to be available under Northwest Central's latest settlement offer.

Kansas Pipeline Co. protested the proposed waiver of CD reduction/conversion rights. According to Kansas Pipeline, Northwest Central has asked the Commission to allow commercial and industrial end users "to use the pipeline facilities of Northwest Central to the exclusion of all other competitors, and . . . to lock out all competitors from offering any amounts of system supply to local distribution companies attached to the Northwest Central system. Such proposed interim transportation is unduly discriminatory and highly anticompetitive as to interstate and intrastate pipeline companies, as well as producers attached to such interstate and intrastate pipeline companies, and would insure market control for Northwest Central."

Conoco Inc., in a petition to intervene, expressed no opposition to the interim transportation authority sought by Northwest Central, provided that it expire 30 days after a Commission decision on the pending settlement offer and related certificate applications or 4/1/87, whichever is earlier. Conoco also sought assurance that grant of interim transportation authority would not affect its rights under Order No. 451 in any way.

FERC Severs "Transition Cost" Issue From Transco Settlement Offer

By order dated 9/16/86, the FERC severed one of two heavily contested issues raised by a comprehensive settlement offer of Transcontinental Gas Pipe Line Corp. (TA85-3-29 et al.) which was certified to the Commission by Administrative Law Judges Brenda Murray, Bruce Birchman and Thomas Megan[1] on 6/26 and 6/27/86.

The severed issue involves Transco's proposal to bill monthly surcharges to its customers over a five-year period to amortize $82 million of "transition gas costs," (including $75 million attributable to deferred gas costs and $7 million attributable to certain system imbalances resulting from previous take-or-pay settlements). The Commission concluded that this "transition cost" issue raised genuine questions of material fact, and that the record was insufficient to permit a reasoned decision. The issue was therefore remanded to the ALJ panel.[2] On the other hand, the Commission found substantial record evidence on which to base a reasoned decision with respect to a second highly disputed issue, namely, a proposed 50-50 sharing between Transco and its customers of buyout or buydown payments made by Transco to resolve take-or-pay or other obligations in problem contracts with producers. (The customers' share of these payments would be recovered through directly billed monthly surcharges over a five-year period.) Hence, the Commission did not sever the take-or-pay buyout issue but instead will consider it as part of the overall settlement proposal.

Transco's proposed surcharges to recover "transition costs" and "take-or-pay buyout costs" were only two of many provisions included in its overall settlement offer, filed 5/13/86 in revised form. Some other provisions would implement "open access" firm and interruptible transportation on a first-come, first-served basis, subject to available pipeline capacity; permit contract demand reductions and offer various options for converting sales entitlements to firm transportation; impose best-efforts purchase obligations on customers during a nine-month transition period ending 3/31/87; reduce the cost of gas underlying Transco's sales from $3.11 to $2.30/dth during the same transition period (this reduced cost was implemented by Transco effective 5/1/86 and is in effect at this time); and state Transco's commitment to renegotiating or settling producer contracts so as to provide market-responsive pricing and other terms. The revised settlement offer generated considerable opposition. Producers and end users, for example, attacked the open access transportation provisions, including transportation conversion rights and rates, as highly discriminatory in favor of Transco's distributor customers. The "transition cost" and "take-or-pay buyout" provisions were questioned by several distributors, and certain distributors (Philadelphia Gas Works and Philadelphia Electric Co.) recommended that the "transition cost" matter be severed and set for hearing. Transco's proposal to surcharge customers for $82 million of underrecovered gas costs incurred in a past period is "extraneous" to open access issues and should be examined along with other prudency questions in a PGA proceeding, the distributors argued.

---

[1] The Transco settlement offer involved issues pending in various proceedings before three different law judges. Hence, all three were involved in certifying the proposed settlement, as well as in a prior decision to require hearings on two of the contested issues.

[2] Judge Murray has been designated to preside over proceedings on the remanded issue. A prehearing conference is set for 10/2/86.

Before certifying the settlement offer to the Commission, the three administrative law judges ordered a prehearing conference to determine whether Transco viewed the "buyout" and "transition cost" issues so integrally related to the overall settlement as to preclude severance and separate trial, or alternatively to consider procedures for supplementing the record. At the conference on 6/12/86, Transco maintained that the "buyout" and "transition cost" issues were part of a package deal and could not be severed, but it agreed to make a witness available for cross-examination on these provisions. During four days of hearings later that month, testimony was presented by both Transco and the Pennsylvania Consumer Advocate and cross-examined. At the conclusion of the hearings, nine parties opposed certification of the revised settlement offer and urged severance and separate trial of one or both of the contested issues, while 11 others recommended certification. In deciding to certify the settlement offer, the administrative law judges all agreed that the record contained substantial evidence from which the Commission could reach a decision on the merits of the two contested issues. The administrative law judges also certified a motion to waive on initial decision.

Thereafter, Philadelphia Electric petitioned the FERC to sever the "transition cost" issue from the certified settlement offer or, alternatively, to require an initial decision. The distributor stressed the need for a full evidentiary hearing "to sort out the confused factual basis" for Transco's claim to recover an $82 million transition cost and saw no reason why this issue could not be severed since it was not integrally related to the overall settlement. In addition, Columbia Gas Transmission Corp. -- a vehement opponent of the settlement offer -- moved the Commission to reject the administrative law judges' certification and to compel issuance of an initial decision. (See REPORT NOS. 1568, pp1-4; 1572, pp17-29; 1576, pp25-27.)

The FERC's action severing the transition cost issue effectively grants Philadelphia Electric's petition. The severed issue was remanded to the panel of administrative law judges for further hearings. The Commission also denied waiver of the initial decision with respect to the transition cost issue, but granted waiver with respect to the buyout cost issue.

Recently, on 8/25/86, Transco requested expedited consideration of its pending settlement offer to implement nondiscriminatory Order No. 436 transportation. Transco maintained that there are "no more important or urgent issues on the Commission's agenda at this time than resolution of Order No. 436 issues." Adding that its system is "poised on the threshold -- some would say precipice -- of the new era of open and aggressive market competition which presents opportunities and challenges to all market sectors and participants," Transco said the importance of its proposed settlement cannot be overemphasized.[1] (See REPORT NO. 1583, pp19-20.)

Transco currently is providing new Section 311 open access transportation pursuant to a decision in last July to go forward with such transportation without awaiting Commission action on the pipeline's earlier request for waiver of the contract

---

[1] During the FERC's open meeting on 9/10/86 when severance of the "transition cost" issue was approved, Commissioner Naeve commented that the Transco situation was a "classic case" of a pipeline attaching fraud and abuse, imprudence and often complicated issues to an Order No. 436 blanket transportation request, thus preventing expeditious action on transportation matters.

demand reduction/conversion requirement of Order No. 436 regulations. The Commission has not acted on that request because Transco did not meet one of the three requisite criteria established for grant of such waivers, namely, commencement of new Section 311 transportation on or before 6/25/86. (See REPORT NO. 1579, pp7-9.)

Columbia Gas Accuses Panhandle and Tennessee of "Cherry Picking" Columbia's Customers

In separate protests filed 9/12/86, Columbia Gas Transmission Corp. contended that Panhandle Eastern Pipe Line Co. (CP86-660-000) and Tennessee Gas Pipe Line Co. (CP86-668-000) are selectively making transportation services available to Columbia's customers and others without providing comparable arrangements to Columbia. Essentially, Columbia alleged that Panhandle and Tennessee have embarked upon a course of "cherry picking" Columbia's customers, and others they choose, while not providing transportation service for all of their customers (including Columbia) on a nondiscriminatory basis. Requesting a hearing, Columbia said the Commission at a minimum "must seek assurances" that the respective pipelines will provide transportation service to any customers who request it.

Columbia's protests were directed to certificate requests by:

(1) Panhandle (CP86-660-000) to transport up to 85,000 Mcf/d on an interruptible basis for Columbia Gas of Ohio (Columbia Ohio) -- Columbia Gas' largest resale customer-- over a primary term of five years (and a secondary term up to five years), and to construct a point of interconnection with Columbia of Ohio in Lucas County, Ohio at an estimated cost of $330,000; and

(2) Tennessee (CP86-668-000) to transport up to 120,000 dt/d on an interruptible basis for AlaTenn Energy Marketing Company, Inc. (ATEMCO), agent for Alabama-Tennessee Natural Gas Company (Alabama-Tennessee), from 17 receipt points in Mississippi and Alabama for redelivery to Alabama-Tennessee in Alcorn County, Mississippi and Colbert County, Alabama. Columbia recently initiated service to Alabama-Tennessee via a new hookup made possible by Order No. 436.

In protesting Panhandle's application, Columbia noted that Panhandle has requested a blanket transportation certificate under Order No. 436 limited to two years. Yet Panhandle seeks to transport to Columbia's largest customer for a period five times as long as the requested blanket certificate authority. The Commission should not issue a certificate without a hearing to determine whether Panhandle's proposal is unduly discriminatory, Columbia said.

Other objections to Panhandle's application were recently lodged by Central Illinois Light Co. (CILCO) and Michigan Consolidated Gas Co. (MichCon.) CILCO alleged the proposed service for Columbia Ohio, an offsystem customer, was unduly discriminatory against Panhandle's General Service customers, would tie up substantial interruptible capacity on Panhandle's system (particularly lines attaching relatively inexpensive supply sources in the West End), and does not identify the service priority relative to onsystem end-users. CILCO said Panhandle had made clear that a distributor cannot purchase system supply as a General Service customer and simultaneously obtain transportation service for gas purchased from others. Thus, customers who currently comprise about 90 percent of Panhandle's system supply sales cannot obtain transportation. As a result, CILCO said they "would be severely prejudiced" because Columbia Ohio might obtain priority over limited and desirable West End capacity. Contrary to Panhandle's representations that it has sufficient capacity, CILCO said it was advised by Panhandle

within the past three months that capacity for volumes less than those sought by Columbia Ohio did not exist from West End receipt points which do not use Panhandle's gathering facilities.

MichCon's complaint was similar to those which it has filed in opposition to virtually all other Panhandle applications for transportation authority under Section 7(c). In essence, MichCon contended that Panhandle's continued refusal to provide interruptible transportation service for MichCon is unduly discriminatory, adding that a contract demand reduction/conversion option, or minimum bill crediting, is an essential precondition for nondiscriminatory transportation.

Columbia's fear of unfair competition by Tennessee was nearly identical to that expressed in its protest to Panhandle's certificate proposal. Noting that Tennessee is not an open-access transporter, Columbia complained that Tennessee seeks to provide transportation service for Alabama-Tennessee while at the same time shutting its system to others. Hence, Columbia "can only assume" that Tennessee has taken these steps to compete with Columbia for the Alabama-Tennessee markets. While it does not question Tennessee's right to compete for a share of the transportation market, Columbia "must question Tennessee's actions when they are discriminatory, thereby providing Tennessee with an unfair competitive advantage."

Columbia's concerns were reflected in a conditional protest to Tennessee's proposal by the Public Service Commission of the State of New York. In the event that Tennessee is not offering to seek Section 7 transportation for all customers, or is placing restrictions upon the type of transportation service it will provide, New York protested the application "on grounds that its approval would constitute an undue discrimination against those customers who do not have access to Section 7 transportation in the Tennessee system."

Colorado Interstate Protests Long-Term Firm Sale Proposed by KN Energy to Public Service Co. of Colorado; Charges Bypass

A contest is developing over an application by KN Energy Inc. (CP86-643-000), filed 7/31/86, seeking Section 7(c) certificate authority to sell natural gas to Public Service Co. of Colorado (PSCo) on a firm basis for a period of 10 years or longer. KN proposes to sell PSCo an initial volume of 25,000 Mcf/d beginning 10/1/86, 30,000 Mcf/d beginning 10/1/87 and 40,000 Mcf/d beginning 10/1/88 through 1996 and year-to-year thereafter. To effect these sales, KN intends to deliver gas for PSCo to its wholly-owned, intrastate affiliate, Colorado Gas Transmission Corp. (CGT), at a "to-be-established" interconnection with CGT in Weld County, Colorado. CGT would then transport gas on behalf of PSCo to an interconnection with Western Gas Supply Company (West Gas), a wholly owned intrastate affiliate of PSCo, for ultimate redelivery to PSCo. KN also proposes to construct certain minor facilities at the proposed interconnection with CGT and at its Huntsman Compressor Station, at an estimated cost of $103,000.

Public Service of Colorado is the largest sales customer of Colorado Interstate Gas Co., which challenged KN's proposal in a protest and request for hearing filed 9/5/86. According to CIG, the project involving KN, CGT, PSCo and West Gas is designed to displace sales or transportation of gas which otherwise is obtainable from CIG.

CIG argued that KN's proposed transportation scheme constitutes a bypass of its own transportation and sales service in the Denver, Colorado market and will have an adverse impact by lowering throughput on CIG's system and thereby requiring a reallocation of costs to CIG's other customers. CIG maintained that it has the ability to provide the same transportation proposed by KN and can do so more economically. In

this regard, CIG announced its intention to file in the near future "an alternative and superior proposal," based on the fact that it has the necessary facilities in place and adequate pipeline capacity to provide the service.

Objections were also expressed by Natural Gas Associates, Inc. (NGA) which is engaged in the gathering, purchasing and reselling of natural gas produced in the Denver-Julesberg Basin of Weld County, Colorado. Requesting either outright denial of KN's application or a hearing, NGA argued that it is currently capable of supplying PSCo at rates provided in sales agreements with CIG that are substantially less than KN's effective rates. "There exists no basis for the Commission to grant KN a certificate to permit the importation of gas from outside the State of Colorado at a higher price and requiring both the payment of a transportation charge and the substantial cost associated with the construction of new facilities, when adequate supplies are available from alternative sources within the State at a substantial savings to PSCo and the consumer," NGA stated.

K N answered CIG's protest in a reply filed 9/16/86. According to KN, CIG's complaint essentially questions the intrastate transportation of gas by CTG, an intrastate pipeline, which is an issue outside the Commission's jurisdiction. The crux of CIG's protest is the claim that it can provide more economic transportation service than CGT with respect to the delivery of gas to PSCo after it is sold by KN. However, KN noted, the Colorado Public Utilities Commission will make the necessary determinations with respect to CGT's proposed facilities and transportation service. Hence, CIG's motion represents an attempt to circumvent the State's jurisdiction by requesting the FERC to conduct duplicative evidentiary proceedings regarding such matters. As for its proposed sale to PSCo and the construction of minor facilities related to the sale, KN alleged that CIG was merely objecting to any attempt to introduce competition into CIG's traditional market area "where CIG has long enjoyed a total monopoly position as the sole interstate pipeline supplier."

Columbia Willing to Temporarily Delay Implementation of Penalties for Monthly Imbalances

On 9/9/86 Columbia Gulf Transmission Co. (RP86-108) and Columbia Gas Transmission Corp. (RP86-112) notified its customers and the Commission that the monthly imbalance penalties included in Columbia's currently effective transportation tariffs would be suspended through at least 12/31/86. In light of this action, Columbia urged the Commission to deny several requests filed earlier this month for a stay of these penalty provisions.

In early September, sharp criticism was levelled by industrial users, producers and natural gas marketers at imbalance and penalty provisions included in Columbia's tariffs. Numerous application were filed on 9/4/86 for rehearing and/or partial stay of an FERC order issued 8/4/86 which accepted, subject to refund, compliance tariff filings by Columbia which include the same terms and conditions as those contained in Columbia's offer of settlement for Order No. 436 transportation (RP86-14 and RP86-15). The protests contested the Commission's action in permitting implementation of tariffs proposed in a controversial settlement offer before reviewing the settlement offer. The protesters stated that the imbalance provisions were confusing and, in some cases, infeasible. Their concern over the balance and banking penalties was heightened, to some extent, by Columbia's inability or unwillingness to explain how the penalties would be implemented at a meeting with the shippers in August.

The tariff sheets of Columbia Gas and Columbia Gulf include penalty charges for unauthorized tenders of gas. Among other penalties, Columbia proposes a monthly charge of $4.00/dth for any deficiencies in tenders without prior notification of the deficiencies and without allowance for make-ups. For excess tenders, Columbia would provide notification and the shipper would be able to work off the excess over the next full billing month. Any continuing excess above 5% of the contract quantity would be assessed a penalty of $2.00/dth each month until the excess volume has been eliminated.[1] (See Report No. 1585, pp21-22.)

Columbia noted that it has become aware of growing confusion over the implementation of the excess monthly imbalance penalty provisions. Columbia admitted that it could not answer all questions and problems raised by the shippers in the recent meeting, but stated that all "matters will be addressed in due course". To work out the proper procedures, Columbia proposed a transition period during which the procedures set forth in the tariffs would be followed, though no penalties would be assessed. During this transition period Columbia would undertake a thorough review of the imbalance penalties and eliminate any defects in the procedures. The transition period would also afford Columbia and its customers time to explore alternative mechanisms to accomplish the desired objectives of these penalty provisions. If Columbia decides to extend the transition period, customers will be notified by 12/1/86.

Columbia, however, also reaffirmed its need for the penalty provisions and urged the Commission to deny the requests for a stay of all penalty provisions. Such action, Columbia stated, "could seriously undermine Columbia's ability to serve its sales markets in the forthcoming winter, to the detriment of all gas consumers dependent upon its supply." Columbia argued that only shippers can control production and it is up to them to accept this responsibility, because Columbia's system cannot sustain an estimated 10-12 Bcf transportation imbalance.

---

[1] The Columbia Gas system would also impose penalties for banking imbalances, involving gas which Columbia Gas delivers to an intermediate transporter to be held for the shipper. Although several interveners strongly opposed implementation of these penalties as well, Columbia did not propose suspension of these penalties during the transition period.

FERC Law Judge Recommends Approval of As-Billed Flowthrough by Northwest Pipeline of Demand/Commodity Rates Paid for Imported Canadian Gas

On 9/4/86 Administrative Law Judge Thomas L. Howe issued an initial decision approving as-billed flowthrough of two-part demand/commodity rates paid by Northwest Pipeline Corp. (TA85-2-37) to Westcoast Transmission Co. Ltd. pursuant to a letter agreement dated 10/1/84.[1] The Law Judge concluded that as-billed flowthrough of pipeline supplier rates is required by FERC regulations. The ALJ further concluded that the prudency of the letter agreement is not a matter for FERC determination in view of certain ERA rulings. Notwithstanding these rulings, he found the interim agreement to be prudent for independent reasons.

Background

This proceeding originated with a revised PGA filing by Northwest in October 1984 to reflect the 10/1/84 letter agreement amending the terms of Northwest's imports from Westcoast during the 1984-1985 contract year (beginning 11/1/84). The interim agreement established a new two-part demand/commodity rate structure to replace the previously effective border price of $4.40/MMBtu. The two-part rate included a monthly demand charge of $6 million and an initial commodity charge of $2.78/MMBtu, subject to quarterly adjustment based on the price of No. 6 fuel oil in the Seattle-Portland area,[2] resulting in an overall average unit rate of $3.40/MMBtu based on sales projections at a 33% load factor. The agreement also provided for price renegotiation at any time to respond to changes in market demand, alternative fuel availability and price, prices of Northwest's domestic supply, governmental or regulatory policy, or other relevant pricing considerations. The agreement specified that Northwest purchase a minimum daily volume of 130,000 Mcf, and a minimum annual volume equal to 42.5% of its actual annual sales up to 262 Bcf plus 75% of actual annual sales in excess of 262 Bcf. The NEB approved the amended terms on 11/1/84, and the agreement was filed by Northwest with ERA for informational purposes. The agreement has since been extended to cover Northwest's imports through 10/31/86. (See REPORT NOS. 1486, pp1-2; 1490, p5; 1553, p14; 1562, p37.)

The FERC suspended the revised PGA proposal and ordered hearings to determine the propriety of as-billed flowthrough treatment of Westcoast's two-part charges, among other issues. Subsequently, on 4/30/85, the Commission directed that these hearings also explore the prudence of Northwest's 10/1/84 letter agreement with Westcoast. This action, taken in response to concerns raised by Southwest Gas Co., Colorado Interstate Gas Co. and Mountain Fuel Resources, Inc., prompted Northwest (85-12-NG) to petition ERA for a determination that the terms of the letter agreement conformed to DOE gas import guidelines, and were not inconsistent with the public interest. In support, Northwest contended that the prudency of its 1984-1985 contract with Westcoast and

---

[1] This is the fourth initial decision in the last year to deal with the question of as-billed flowthrough by domestic pipelines of demand/commodity charges for Canadian natural gas imports. The three earlier decisions involved as-billed flowthrough treatment requested by Transcontinental Gas Pipe Line Corp. (TA85-1-29-005, Sulpetro Issue), Boundary Gas, Inc. (RP85-12-000) and Natural Gas Pipeline Co. of America (TA85-1-26-004). All of the initial decisions recommended as-billed flowthrough treatment. To date, the Commission has taken no action on this issue. (See REPORT NOS. 1533, pp9-11; 1560, pp27-30; 1572, pp40-42.)

[2] These quarterly adjustments have resulted in substantial reductions in commodity rates (and overall rates) since November 1984.

the competitiveness of the projected average import cost ($3.40/MMBtu) could only be addressed by ERA, the agency delegated to authorize imports under Section 3 of the Natural Gas Act. FERC consideration of the prudence of the Westcoast agreement would not only be improper, Northwest said, but also would result in duplicative agency review and in possible inconsistent application of DOE import guidelines. Northwest thus sought findings from ERA in order to resolve the prudence question improperly raised in the FERC proceeding.

In Opinion No. 87 issued 9/10/85, ERA approved the contract amendment as a decided improvement over Northwest's previous import arrangements, stressing the market-responsive price provisions and the reduced overall import price. ERA also approved Northwest's as-billed flowthrough of Westcoast's demand/commodity rates as a means for Northwest and its customers to sell gas at prices more competitive with alternative fuels than was possible before. Finally, ERA asserted exclusive jurisdiction to authorize imports under the NGA. Thus, ERA declared, once it has approved an import arrangement, the FERC may not exercise authority under Sections 4 or 5 of the NGA "in a manner inconsistent with [ERA's] actions" and may not "significantly alter or overturn the arrangements upon which [ERA's] actions are based." ERA denied rehearing in Opinion No. 87-A, issued 11/8/85. (See REPORT NOS. 1531, pp1-6; 1534, pp1-4; 1543, pp22-25.)

Initial Decision

In his initial decision, Judge Howe identified three issues for consideration: (1) whether Northwest was imprudent in entering into the 10/1/84 interim agreement with Westcoast; (2) whether Northwest should be permitted to flowthrough Westcoast's demand-commodity charges on an as-billed basis; and (3) if as-billed flowthrough is permitted, whether any Northwest customers should be permitted to reduce their contract demand obligations to Northwest.

Addressing the first issue, the Law Judge held that ERA Opinion Nos. 87 and 87-A precluded any FERC determination of impropriety regarding the terms of the 10/1/84 letter agreement, including the two-part rates to be paid by Northwest. Nevertheless, the ALJ found that the interim agreement was not imprudent for reasons entirely independent of ERA's action. Specifically, he noted, the agreement resulted in an immediate reduction in rates (from $4.40 to an average of $3.40/MMBtu) with the possibility of still further reductions (since realized) in the event of a decline in No. 6 fuel oil prices. He also noted testimony indicating that the lower commodity rates increased the volume of industrial sales in the Northwest over the level that otherwise might have been expected. While some customers contested the two-part rates as imprudent because certain costs may be shifted to them under as-billed flowthrough treatment, Judge Howe said "Northwest, a fully integrated system, must consider the welfare of its customers as a whole."

Further, the ALJ did not consider it necessary to demonstrate that a contract is "in every respect the best bargain that could have been obtained." Rather, it is enough to show that a person with the information available at the time "would have acted reasonably in entering into this bargain." Given "the drastic price reduction obtained, and a question as to whether any superior bargain could have been driven or approved," Judge Howe found that the agreement was prudent.

Regarding the second issue, the ALJ questioned whether ERA's approval of Northwest's as-billed flowthrough treatment of Westcoast's two-part demand/commodity rates barred the FERC from considering the form of rates to be charged by Northwest to its customers. Carried to its logical conclusion, he stated, this principle would allow

Northwest -- without any Commission review -- to establish its allowed rate of return and dictate virtually all other rate matters through an ERA-approved contract with Westcoast. The Law Judge viewed such a result as an "unwarranted extension" of ERA's powers and an "unwarranted limitation" on the FERC's powers and duties. However, Judge Howe asserted, it is unnecessary to resolve this question since the FERC's own regulations requiring as-billed flowthrough of pipeline supplier rate changes lead to the same determination reached by ERA. Rejecting the contention that this rule applies only to jurisdictional domestic pipelines, the ALJ found nothing in the language of the above rule or its underlying history to indicate an exception for nonjurisdictional pipeline suppliers.

With respect to the final question (which was not decided by ERA), the Law Judge noted the position of Colorado Interstate and Mountain Fuel that their contract demands should be reduced to mitigate the impact of cost shifts caused by as-billed flowthrough. Although finding that the Commission has power to order contract demand relief in this proceeding, Judge Howe concluded that it was preferable to leave this matter to negotiations between the parties. CIG and Mountain Fuel are not without bargaining power, he pointed out, and they may be able to trade an extension of lesser contract demands in return for present reductions.

Recent Canadian Gas Developments

Recently, the National Energy Board of Canada instituted procedures to streamline its review of natural gas prices, including natural gas export prices. In the U.S. the Economic Regulatory Administration continues to receive and approve requests for blanket import authorizations and other short-term imports and/or exports. Over the past several weeks, ERA has also received and approved modifications to existing import arrangements.

NEB Pricing Procedure

On 8/27/86 the Canadian National Energy Board announced new streamlined procedures for the administration of natural gas prices. The new procedures will enable the NEB to approve contract prices within days of filing the contract. Previously it could take several weeks for the NEB to approve the contract price. The new guidelines cover both gas sold within Canada and gas which is exported.

The new general pricing orders cover approval of prices paid to purchase gas within a given province and outside a given province for either consumption in Canada outside the province or for export. The new orders permit a more generalized method of approving prices paid for natural gas within a province for subsequent sale and consumption outside the province. Among other things, the NEB would no longer be required to approve the prices of each sales transaction. Instead, the NEB will review executed contracts merely to ensure that a price is clearly established and/or calculable under the contract pricing provisions and that the documents are fully executed. Normally, the NEB will acknowledge a contract filing within three working days from the date the documents are received. Where marketers, brokers or a consortium of producers are involved in the sale of gas under numerous contracts, the Board recognized that filing of all the contracts could become an onerous burden. Hence, under these circumstances, it will accept a summary of contractual obligations. All contracts and contract amendments filed at the NEB will be kept confidential.

Import Applications

ERA received three more applications for authorization to import natural gas for short-term or spot sales.

1. Kerr-McGee Chemical Corp. (86-51-NG) requested authorization to import up to 18 MMcf/d at a contract price of $2.28/MMBtu for a term extending from 11/1/86 through 10/31/88. The gas would be used by Kerr-McGee Chemical used in the operation of its inorganic chemical plants in California for heating and manufacturing purposes.

2. Bonus Energy, Inc. (86-52-NG) requested blanket authorization to import up to 100 MMcf/d, and a maximum of 50 Bcf, over a term of two years beginning on the date of first delivery. With this authorization, Bonus would aggressively market gas produced by its affiliate, Bonus Gas Processors Corp., and also would market gas supplies of other producers.

3. Wessely Marketing Corp. (86-53-NG) requested blanket authorization to import up to 100 Bcf over a two-year period for sale on a short-term or spot basis. Wessely is a subsidiary of Wessely Energy Corp., a Texas corporation engaged in the production and sale of natural gas.

In addition, ERA received a request from Tennessee Gas Pipeline Co. (86-54-NG) to amend its import authorization. The principal changes, set forth under a contract amendment with ProGas Ltd. dated 8/25/86, are (1) the elimination of fixed producer costs from the monthly demand rate, and (2) the reduction of the annual minimum take volume from a load factor of 60% to a load factor of 40%.

Import/Export Authorizations

In the past several weeks, the ERA approved one more application for short-term blanket imports and one more application for short-term blanket import/export authorization.

1. Opinion No. 142, issued 8/27/86, approved a request by Spot Market Corp. (86-38-NG) to import up to 50 Bcf per year over a two-year period for short-term or spot sales.

2. Opinion No. 144, issued 9/9/86, approved a request by Hadson Canada (86-35-NG) for blanket authorization to import and export natural gas for short-term sales. Hadson may import up to 50 Bcf of gas over a two-year period for sale in the U.S. and export up to 20 Bcf over the same period for sale in Canada. Hadson is a wholly-owned subsidiary of Hadson Gas Systems, Inc., which in turn is wholly-owned by Hadson Petroleum Corp.

ERA also approved an amendment to an existing import authorization. In Opinion No. 143, issued 9/5/86, Vermont Gas Systems Inc. (86-37-NG) received authorization to increase its maximum daily contract quantity from 25,600 Mcf to 28,000 Mcf for the contract year ending 10/31/87, up to 30,000 Mcf during the contract year ending 10/31/88, and up to 32,000 Mcf for the contract year ending 10/31/89. Vermont Gas receives Canadian Gas from TransCanada Gas Pipelines Ltd.

Marie - DO WE [illegible]

1294/Sept. 26, '86

TENNESSEE FILES AT ERA FOR CONTRACT AMENDMENT COVERING GAS PRICE CHANGES

TENNESSEE asked ERA Sept. 16 for an amendment covering changes in the price of natural gas being imported under a sales agreement with ProGas Ltd.

Tennessee is authorized to import up to 75,000 Mcf per day through Oct. 31, 2000.

Among points cited in the renegotiated pricing agreement:

-- The monthly demand rate is reduced by deletion of that portion relating to fixed producer costs, which is expected to result in a reduction from the $15.21 negotiated monthly demand rate currently in effect, and in a substantial reduction from the rate that would have become effective on Nov. 1, 1986.

-- Tennessee will be obligated to take or pay for a minimum monthly quantity equal to 20% of the daily contract quantity times the number of days in the month. The commodity price of this gas will be equivalent to the lesser of the weighted average cost of gas which Tennessee must take because of its minimum take obligations to other suppliers or Tennessee's system-wide filed weighted average cost of gas for field purchases.

-- Tennessee will have opportunity to purchase monthly up to 60,000 Mcf per day of market responsive gas at such commodity price as the parties establish through month-to-month negotiation. (Docket [illegible])

Executive Enterprises to Sponsor Conference in Mid-November in Arlington, Virginia on Natural Gas Purchasing Strategies

Executive Enterprises will sponsor a two-day conference on natural gas purchasing strategies at the Hyatt Arlington in Arlington, Virginia (Washington, D.C. area). The conference will take place 11/17 and 11/18/86. The conference chairman is Edward J. Grenier, Jr., partner of Sutherland, Asbill & Brennan.

The conference will include sessions reviewing FERC current attitudes, open access transportation under Order No. 436 and old gas pricing changes under Order No. 451; state regulation; end-user options for purchasing gas (from local distributors, marketers/brokers, and directly from producers); development of customers' own reserves; negotiation of contracts and tariff provisions; use of agency agreements for purchasing and transportation; and perspectives, roles and strategies of pipelines, distributors, producers, marketers/brokers and end users.

The conference registration fee is $795 ($695 for each additional registration from the same organization). To register or obtain information, call Executive Enterprises (800) 223-0787. Reference Session No. 6BDOE29/E6208.