

BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To Senator Howard M. Metzenbaum

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Pipeline Purchases Of High-Cost Natural Gas: Extent And Contested Issues

Natural gas produced under certain high-cost conditions is not subject to Federal price regulation. However, pipeline companies still need Federal approval to pass through such costs to their customers. Pipeline company purchases of such gas have been challenged before the Federal Energy Regulatory Commission by distribution companies, State and local governments, and others.

This report discusses

- the extent of purchases and the prices paid for such gas by 20 major pipelines,
- issues raised in challenges to such purchases and company responses, and
- the status of major cases involving such purchases.



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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ENERGY AND MINERALS
DIVISION

B-206517

The Honorable Howard M. Metzenbaum
United States Senate

Dear Senator Metzenbaum:

Based on your letter of September 8, 1981, and subsequent discussions with your office, we have compiled information on certain aspects of pipeline company purchases of high-cost natural gas. Prices for most high-cost gas are not subject to a Federal price ceiling; however, pipelines still need Federal approval to pass through such costs to their customers. Accordingly, this report provides information on

- the volumes purchased, prices paid, and total costs of high-cost gas purchased by 20 major pipelines;
- issues raised before the Federal Energy Regulatory Commission (FERC) in administrative proceedings relating to the purchase of high-cost gas; and
- the status of selected proceedings.

This letter summarizes the results of our work. Additional information is contained in three appendices.

SCOPE AND METHODOLOGY

In compiling this information, we reviewed selected aspects of the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978, and implementing regulations; examined FERC records and held discussions with FERC officials; and analyzed data submitted by pipeline companies to FERC.

To obtain information on pipeline purchases of high-cost natural gas, we analyzed data supplied by 20 large interstate pipeline companies to FERC in support of their applications to pass through their gas purchase costs. These companies account for more than 90 percent of gas sold in interstate commerce. Additional information on our approach appears on pages 4-6 of Appendix II.

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To identify what issues relating to the purchase of high-cost gas had been raised in challenges to pipeline applications and to determine the current status of selected proceedings, we reviewed FERC files and industry trade journals and held discussions with FERC officials.

This study was performed in accordance with "Standards for Audits of Governmental Organizations, Programs, Activities, and Functions," by the Comptroller General, 1981 Revision.

BACKGROUND

Natural gas accounts for more than one-quarter of the Nation's energy use. Production, transmission, and distribution of natural gas are regulated by various levels of government.

The Federal Government primarily regulates prices paid to producers and interstate transmission of gas. The Federal agency which implements producer price and interstate pipeline regulation is FERC, which was assigned most of the functions of the former Federal Power Commission.

The current framework for price regulation stems from the Natural Gas Policy Act of 1978. The act established eight major price categories, and additional sub-categories, depending on when a well was drilled, how deep the well is, when the gas was contracted for, and other criteria. The highest allowable prices are for "high-cost gas," covered by Section 107 of the act. This section includes (1) gas produced from certain wells more than 15,000 feet deep, which is no longer regulated and has sold for \$9.00 or more per thousand cubic feet; (2) gas from so-called "tight formations," which had a ceiling of \$5.22 per thousand cubic feet in March 1982; and (3) several smaller sources.

Federal regulation of interstate transmission of natural gas dates from the Natural Gas Act of 1938. A key aspect is the setting of tariffs, or rates, that may be charged. In general, pipelines are allowed to charge their customers a rate which enables them to recover direct expenditures--such as the natural gas they buy from producers--and to earn a fair and reasonable rate of return on their pipelines and other investments.

Pipeline tariff rates are established at least every 3 years based on a cost-of-service review. One aspect of such a review is a determination of the cost of gas purchased by the pipeline for resale. Recognizing that purchased gas costs would likely change more frequently than every 3 years, pipelines were allowed, starting in 1972, to adjust their rates in the intervening period.

A pipeline's request to change its base tariff rates to reflect purchased gas costs is known as a purchased gas adjustment filing. Most interstate pipelines (56 of 61) file an application every 6 months, while the remainder file annually. These filings are subject to FERC review and approval.

Purchased gas adjustment filings have become more controversial in recent years, as wellhead prices have accounted for a larger share of retail gas costs. More filings, especially those containing deregulated gas, have been challenged before FERC by outside parties.

SECTION 107 GAS--VOLUMES
PURCHASED AND PRICES PAID

We analyzed purchases of Section 107 gas by six companies in one period and purchases by those six companies and fourteen other companies in the next two periods. (These periods generally correspond to each company's three most recent filings as of late 1981.) Our analysis shows considerable variation, both from pipeline to pipeline and from period to period, in terms of (1) volumes purchased, (2) average prices paid, and (3) total costs.

Both the quantity of Section 107 gas purchased and that quantity as a proportion of total gas purchased increased in most cases. By the third period, Section 107 gas accounted for 5 percent of all purchases. The proportion for individual companies varied: at the three companies with the smallest purchases it constituted none or a negligible amount of all gas, while at the three companies with the largest purchases it constituted 10 percent of more of all gas.

Data on the average prices paid, available only for the latter two periods, also show considerable variation. There was an overall increase from \$5.90 to \$7.32 per thousand cubic feet. In the third period, prices paid by individual companies ranged from \$3.75 to \$8.81 per thousand cubic feet.

The total costs of Section 107 gas purchased depend on both the quantity purchased and the average price paid. Here, too, there was considerable variation. Both the total costs of Section 107 gas and those costs as a proportion of the total increased in most cases. By the third period, Section 107 gas accounted for 17 percent of total costs overall. The proportion at individual companies varied: at the three companies that bought little or none, this gas accounted for little or no cost, while at three highest companies it accounted for 32 percent or more of total costs.

CASES INVOLVING DEREGULATED GAS

Filings by six companies were protested in 1981 because of issues relating to the purchase of deregulated gas. These six companies were among the first to include substantial purchases of such gas in their filings.

The protesters include local distribution companies, State and local governments, State public utility commissions, and industry associations. They contended, in part, that

- prices paid for deregulated gas were too high in relation to prices for competing fuels;
- prices paid to pipeline affiliates were too high; and
- pipelines bought more deregulated gas than they needed.

The pipeline companies involved in the six cases responded, in part, that

- the deregulated gas was purchased to obtain adequate reserves for their customers;
- the protesters did not show that the purchases were unwarranted; and
- the protesters were attempting to reimpose price ceilings on deregulated gas.

FERC's review of purchased gas adjustment filings may involve numerous steps and may take many months to complete. The duration of an individual proceeding depends on the components of the review process itself, the nature of the case, and other factors.

With respect to the five open leading cases, through the end of February 1982, an average of more than 13 months had passed since the applications were filed; the sixth case was completed in 6 months, when the protesters withdrew their objections. Because the Commission has not ruled before on some of the issues presented by these cases and because of the many factors that can affect the duration of a proceeding, it is not possible to estimate reliably when the ongoing cases will be completed.

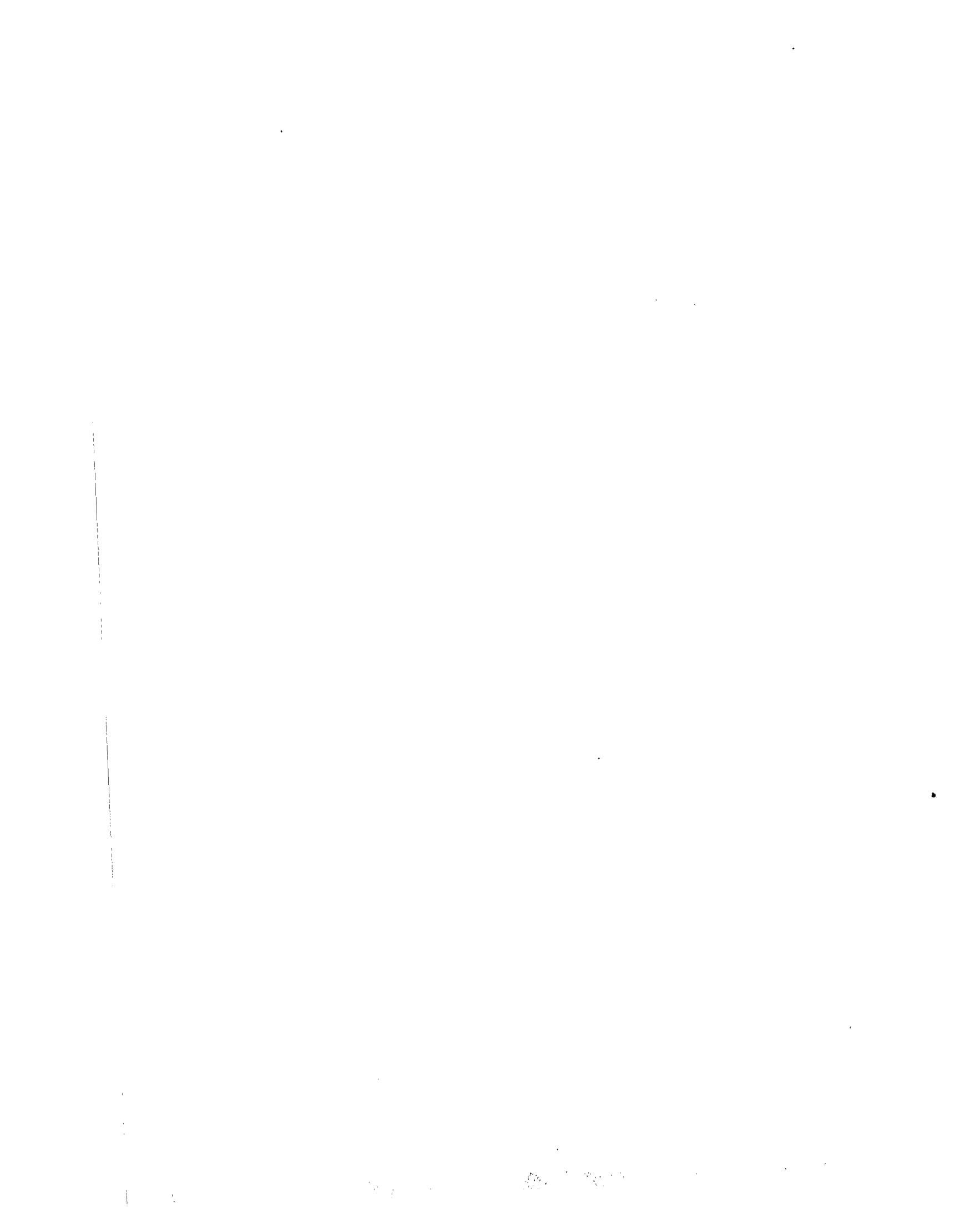
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As requested by your office, we did not obtain official comments on this report from the Federal Energy Regulatory Commission. However, we discussed this report with Commission officials to assure its accuracy and balance. Further distribution of this report will be restricted for 30 days or until released by your office.

Sincerely yours,


J. Dexter Peach,
Director

Attachments - 3



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ABBREVIATIONS

Bcf	billion cubic feet
FERC	Federal Energy Regulatory Commission
Mcf	thousand cubic feet
NGPA	Natural Gas Policy Act of 1978
PGA	purchased gas adjustment
Tcf	trillion cubic feet

BACKGROUND

Natural gas accounts for more than one-fourth of the Nation's energy use, and is used throughout the economy. In 1981, natural gas use totalled almost 20 Tcf (trillion cubic feet), ^{1/} nearly all of it produced domestically. Consumption of gas is distributed among the industrial sector (about 42 percent), the residential and commercial sector (37 percent), electric utilities (19 percent), and transportation (3 percent).

This introductory section discusses regulation of natural gas in general and the specific role of a purchased gas adjustment filing.

The natural gas industry is typically divided into the following levels:

- producers, which extract gas from the ground, and are located principally in Louisiana, Texas, and Oklahoma, the three largest producing States;
- pipelines, or transmission companies, which transport gas from the producing areas to user markets nationwide; and
- distributors, which sell the gas to those who use it.

In some cases, however, major users may purchase gas directly from a producer or pipeline. Furthermore, some companies are involved in more than one stage of this chain.

Production, transmission, and distribution of natural gas are regulated by various levels of government. Production is subject to price regulation primarily at the Federal level and other regulation at the State level. Transmission of gas across State lines (by interstate pipelines) is subject to regulation primarily at the Federal level, while transmission entirely within a State (by intrastate pipelines) is subject primarily to State regulation. Distribution is subject primarily to State or local regulation.

Federal price regulation of production generally began after a 1954 Supreme Court decision and at first covered only gas sold in interstate commerce. The Natural Gas Policy Act of 1978 (15 U.S.C. 3301) extended price regulation to gas sold in intrastate commerce.

^{1/}Natural gas is often sold on the basis of volume. Frequently used measures include thousand cubic feet (Mcf), billion cubic feet (Bcf), and trillion cubic feet (Tcf).

The act also established eight major price categories, covered by Sections 102 through 109, and additional sub-categories, depending on when a well is drilled, how deep the well is, when the gas was contracted for, and other criteria. The maximum ceiling prices for March 1982, for example, ranged from under \$1.00 per Mcf for gas from wells commenced in 1972 or earlier to \$5.22 per Mcf for gas from so-called "tight formations." In addition, some gas--primarily that produced from certain wells more than 15,000 feet deep--is not subject to a price ceiling, and some sales in excess of \$9.00 per Mcf have been reported. (Gas from deep wells and tight formations, plus a few other sources, is covered by Section 107.)

Federal regulation of interstate transmission dates from the 1938 Natural Gas Act (15 U.S.C. 717). Pipeline regulation is pervasive, covering such areas as who may be served, what prices may be charged, and how shortages would be allocated among customers.

The Federal agency that implements producer and interstate pipeline regulation is the Federal Energy Regulatory Commission (FERC). FERC was established as an independent regulatory agency within the Department of Energy, and began operations on October 1, 1977. FERC was assigned most of the functions of the former Federal Power Commission.

A key aspect of FERC's regulation of interstate pipelines is the setting of tariffs, or rates, that may be charged. Pipelines are generally allowed to charge their customers a rate which enables them to recover direct expenditures--such as the natural gas they buy from producers--and to earn a fair and reasonable rate of return on their pipelines and other investments.

Pipeline tariff rates are established at least every 3 years based on a cost-of-service review. One aspect of a cost-of-service review is a determination of the cost of gas purchased by the pipeline for resale. Recognizing that purchased gas costs would likely change more frequently than every 3 years, pipelines were allowed, beginning in 1972, to adjust their rates in the intervening period. This action was taken to save pipelines the interest costs associated with financing higher costs for purchased gas, costs which would eventually be passed on to consumers as part of the companies' cost-of-service ratemaking.

A pipeline's request to change its base tariff rates to reflect purchased gas costs is known as a purchased gas adjustment (PGA) filing. Most interstate pipelines (56 of 61) file a PGA application every 6 months, while the remainder file on an annual basis. PGA filings are subject to FERC review and approval.

Prior to passage of the act, according to a FERC official, PGA filings were a rather routine and mechanical calculation used to reflect gradual changes in gas costs brought about by changing gas wellhead prices, which were closely regulated by the

Federal Government. As such, there was little controversy surrounding most PGA filings. However, this has changed significantly in the last few years. By 1980, wellhead prices accounted for 48 percent of the average retail gas price to consumers, compared to 25 percent in the 1960's, according to American Gas Association statistics. As a result, more PGA filings, specifically those containing deregulated Section 107 gas, are being challenged by outside parties.

Since deregulation of most Section 107 gas in November 1979, the PGA filings of six companies have been suspended and set for hearings, primarily on the basis of protests relating to the price that companies are paying for Section 107 gas. (These cases are discussed in appendix III.) Further, the PGA filings of several other companies have been suspended without protest pending resolution of the six precedent-setting cases. Numerous other PGA filings containing Section 107 gas in small quantities or at relatively low prices have been approved because there were no protests by outside parties.

SECTION 107 GAS--VOLUMES PURCHASEDAND PRICES PAID

Prices paid to producers of Section 107 deep gas have not been subject to Federal price controls since November 1, 1979. It has been reported that many contracts for deregulated gas since then have provided for prices far above ceilings for other categories of gas. Accordingly, there has been considerable interest in purchases of such gas. Presented below is information on volumes purchased, average prices paid, and total costs for Section 107 gas.

SCOPE AND METHODOLOGY

To obtain information on the amount and cost of Section 107 gas, we reviewed PGA filings submitted by 20 interstate pipelines to FERC. These pipelines account for more than 90 percent of all gas sold in interstate commerce. 1/ Below are described (1) the data sources used, (2) certain limitations of the data, and (3) the time periods covered.

A PGA filing, as submitted to FERC, is based on a company's estimate of gas costs for a future period. The company submitting a filing represents that the data are accurate, but--as submitted--the data have not been verified by FERC, nor did we attempt independently to verify the data. The company's estimates for a given period may vary from the actual magnitudes later established because weather patterns, business conditions, inflation rates, and other factors may vary from company estimates. However, over longer periods the estimates are reasonably accurate on average, according to an FERC official.

1/The 20 pipelines are listed below, with both the full name and the brief version by which they are cited in this report: Cities Service Gas Co. (Cities Service); Colorado Interstate Gas Co. (Colorado); Columbia Gas Transmission Corp. (Columbia); Consolidated Gas Supply Corp. (Consolidated); El Paso Natural Gas Company (El Paso); Florida Gas Transmission Co. (Florida); Kansas Nebraska Natural Gas Co. (Kansas-Nebraska); Michigan Wisconsin Pipe Line Co. (Michigan-Wisconsin); Natural Gas Pipeline Co. of America (Natural); Northern Natural Gas Co. (Northern); Northwest Pipeline Corp. (Northwest); Panhandle Eastern Pipe Line Co. (Panhandle); Southern Natural Gas Co. (Southern); Tennessee Gas Pipeline Co. (Tennessee); Texas Eastern Transmission Co. (Texas Eastern); Texas Gas Transmission Co. (Texas); Transcontinental Gas Pipe Line Corp. (Transcontinental); Transwestern Pipeline Co. (Transwestern); Trunkline Gas Co. (Trunkline); and United Gas Pipe Line Co. (United).

Furthermore, the information characterized as "price" may vary from pipeline to pipeline and even within a single filing. The "price" shown may include not only the compensation for a given quantity of gas but certain taxes and other charges. Moreover, the "prices" reported for various transactions are not standardized according to energy content of the gas (usually expressed in terms of Btu's--British thermal units) nor according to pressure (usually expressed in PSI--pounds per square inch).

Some large pipelines recently began voluntarily submitting to FERC computer tapes in connection with their PGA filings. FERC has arranged for data from other pipelines to be put onto computer tapes. These tapes contain essentially the same information as the company's initial paper, or "hard," copy filing with FERC, according to our limited comparisons and our discussions with FERC officials. However, companies sometimes amend the paper copy to correct arithmetic errors or to incorporate other changes, but the computer tapes are not necessarily revised accordingly. These tapes were available for 20 large pipelines for recent filings, and at our request, FERC arranged for certain computations based on the tapes.

Most pipelines submit PGA filings twice a year, on a staggered basis. A few companies submit filings once a year. Among the 20 companies whose data we reviewed, 18 file semi-annually and 2 file annually. Based on the computer tapes, we analyzed the two most recent filings for the former and the most recent filing for the latter, as of late 1981. Subject to data availability and quality, the filings were generally submitted during the first half of 1981 (filing II) and the last half of 1981 (filing III). In addition, for the six companies whose filings are considered to be precedent-setting, we analyzed the previous filing, generally from the last half of 1980 (filing I). ^{1/} We did this manually because computer tapes were not available for that time period and because the PGA filings are so voluminous (typically hundreds of pages long).

To allow comparisons between the second and third filings, the data were converted to an annual basis for companies which file semi-annually. Companies which file on an annual basis were treated as if they filed semi-annually, that is, their annual filings were assumed to be identical semi-annual filings converted to an annual basis. This was done in order to have data for the same number of companies (20) for both filings.

As a result of the steps taken to provide comparable data, the volumes, prices paid, and total costs of Section 107 gas

^{1/}The six companies are Colorado, Columbia, Michigan-Wisconsin, Southern, Transcontinental, and Trunkline. The status of their proceedings is discussed in appendix III.

shown below are only representative values, especially when totals are used for the 20 companies.

Finally, PGA filings--in the form of either paper copy or computer tapes--do not distinguish between the various types of gas described in Section 107 of the NGPA. Most gas categorized as Section 107 is not subject to FERC price regulations because it is produced from a well which was drilled on or after February 1977 and located at a depth of more than 15,000 feet; FERC issued regulations on November 1, 1979, which removed the price ceiling on such gas. However, gas produced under other conditions is also included in Section 107--primarily gas produced from so-called "tight formations." This gas is subject to a price ceiling.

VOLUME

Between November 1, 1979--when the price of Section 107 deep gas was deregulated--through December 1981, 61 pipeline companies submitted 243 PGA filings. Of these, 100--or 41 percent--contained some Section 107 gas. The volume of Section 107 gas reported during the three filings for which we have data varied, both from pipeline to pipeline and from filing to filing. Variations existed both in the quantity of Section 107 gas purchased and in this quantity as a proportion of all gas purchases. (See table 1 on page 7.)

In terms of the quantity of Section 107 gas purchased, data for the first filing for the six pipelines with precedent-setting cases show a range from none by Southern to 42.6 Bcf by Transcontinental. Data for all 20 pipelines for filings II and III show total purchases of 401.5 Bcf and 518.4 Bcf, respectively. The amounts purchased by individual companies in the second filing were lowest for Cities Service, Consolidated, and Northwest (each of which purchased none) and were highest for Trunkline (57.5 Bcf), Southern (68.7 Bcf), and Transcontinental (95.1 Bcf). In the third period, the amounts were lowest for Consolidated (which bought none) and Natural and Northwest (each of which bought less than 2 Bcf) and were highest for Southern (55.6 Bcf), Columbia (61.9 Bcf), and Transcontinental (87.8 Bcf).

In terms of Section 107 purchases as a proportion of total purchases, data for the six companies for the first filing show a range from none by Southern to 5 percent by Transcontinental. Data for all 20 companies for the next two filings show overall percentages of 4 percent and 5 percent, respectively. The proportions for individual companies for the second filing were lowest for Cities Service, Consolidated, and Northwest (each of which bought none) and were highest for Colorado and Transcontinental (11 percent each) and Southern (15 percent). For the third filing, the lowest proportions were for Consolidated (which bought none) and Natural and Texas Eastern (negligible proportions each) and were highest for Transcontinental (10 percent) and Colorado and Southern (12 percent each).

Table 1

AMOUNT OF SECTION 107 GAS PURCHASED

Pipeline Company	Volume of Section 107 Gas Purchased (in Bcf)			Section 107 Gas as a Proportion of All Gas (in percent)		
	Filing (note d)			Filing (note d)		
	I	II	III	I	II	III
Cities Service	(c)	-	11.3	(c)	-	4
Colorado	7.2	30.7	34.6	2	11	12
Columbia	8.4	4.2	61.9	2	1	9
Consolidated	(c)	-	-	(c)	-	-
El Paso	(c)	34.9	43.6	(c)	3	4
Florida	(c)	13.6	8.5	(c)	10	6
Kansas-Nebraska	(c)	3.5	3.5	(c)	5	5
Michigan-Wisconsin	4.5	16.9	41.2	1	3	7
Natural	(c)	(a)	1.8	(c)	(b)	(b)
Northern	(c)	5.6	5.6	(c)	1	1
Northwest	(c)	-	1.6	(c)	-	1
Panhandle	(c)	4.6	4.3	(c)	1	1
Southern	-	68.7	55.6	-	15	12
Tennessee	(c)	4.7	24.5	(c)	1	2
Texas Eastern	(c)	(a)	2.0	(c)	(b)	(b)
Texas	(c)	26.3	35.9	(c)	6	8
Transcontinental	42.6	95.1	87.8	5	11	10
Transwestern	(c)	3.0	10.0	(c)	1	4
Trunkline	11.0	57.5	50.8	2	10	9
United	(c)	31.8	33.8	(c)	4	5
TOTAL	(c)	401.5	518.4	(c)	4	5

a/Less than 0.5 Bcf

b/Less than 0.5 percent

c/Not computed

d/Filing I generally includes filings submitted during the second half of 1980; Filing II, the first half of 1981; and Filing III, the second half of 1981.

Comparing purchases between filings II and III shows that both the quantity of Section 107 gas and that quantity as a proportion of the total increased in most cases. For the six companies for which data are available for the first filing, the quantity purchased in the later filings was higher in almost all cases. For the 18 companies which file semi-annually, the quantity purchased increased from the second to the third filings in 12 cases, was the same in 1 case, and was less in 5 cases.

Likewise, comparing proportions shows that for the six companies the percentages generally increased from the first filing to the later filings. For the 18 companies which file semi-annually, the proportion went up in 10 cases, stayed the same in 4 cases, and declined in 4 cases.

Finally, in the second filing, Section 107 gas constituted 1 percent or less of total purchases for nine companies, 2 to 9 percent for six companies, and 10 percent or more for five companies. In the third filing, it constituted 1 percent or less for six companies, 2 to 9 percent for eleven companies, and 10 percent or more for three companies.

PRICE

Data on the average price paid per Mcf of Section 107 gas are available only for filings II and III. They show considerable variation among companies in both filings. (See table 2 on page 9.)

The average for all pipelines was \$5.90 in the second filing and \$7.32 in the third filing. Among the 17 companies that bought Section 107 gas in the second filing, the lowest prices paid were \$4.38 by El Paso, \$4.47 by Texas Eastern, and \$4.49 by Northern; the highest prices paid were \$6.54 by Columbia, \$6.62 by Southern, and \$6.87 by Texas. Overall in the second filing, eight companies paid less than \$5.00, three companies paid between \$5.00 and \$5.99, and six companies paid \$6.00 or more.

Among the 19 companies that bought Section 107 gas in the third filing, the lowest prices paid were \$3.75 by Natural, \$3.92 by Texas Eastern, and \$4.49 by Northern; the highest prices paid were \$8.25 by Tennessee, \$8.61 by Southern, and \$8.81 by Texas. Overall in the third filing, three companies paid less than \$5.00, four companies paid between \$5.00 and \$5.99, and twelve companies paid \$6.00 or more.

Comparing prices paid by 15 companies (those which file semi-annually and which bought Section 107 gas in both periods) shows that the average went up for 12 companies and went down for the 3 other companies.

Table 2AVERAGE WEIGHTED PRICE OF SECTION 107 GAS

<u>Pipeline Company</u>	<u>Price per Mcf</u>	
	<u>Filing (note a)</u>	
	<u>II</u>	<u>III</u>
Cities Service	-	\$5.14
Colorado	\$6.00	7.47
Columbia	6.54	7.76
Consolidated	-	-
El Paso	4.38	6.13
Florida	4.60	5.84
Kansas-Nebraska	6.39	6.39
Michigan-Wisconsin	4.96	7.09
Natural	4.58	3.75
Northern	4.49	4.49
Northwest	-	5.19
Panhandle	4.89	6.46
Southern	6.62	8.61
Tennessee	4.63	8.25
Texas Eastern	4.47	3.92
Texas	6.87	8.81
Transcontinental	5.80	6.89
Transwestern	5.86	5.49
Trunkline	6.48	7.88
United	5.85	6.83
TOTAL	\$5.90	\$7.32

a/Filing II generally includes filings submitted during the first half of 1981; Filing III, the second half of 1981.

TOTAL COST

The total cost of Section 107 gas depends on both the quantity purchased and the price paid. Just as with quantity and price, total cost varied from company to company and from filing to filing, and in terms of both expenditures for Section 107 gas and such expenditures as a proportion of the total. (See table 3 on page 11.)

The total cost for the six pipelines in the first filing ranged from none for Southern (which bought no Section 107 gas) to \$214.2 million for Transcontinental. Data for all 20 pipelines for the next two filings show total costs of about \$2.4 billion and \$3.8 billion, respectively. The total cost to individual companies in the second filing was lowest (none) for the three pipelines that bought no Section 107 gas and highest for Trunkline (\$373.0 million), Southern (\$454.9 million), and Transcontinental (\$552.0 million). In the third filing, the total cost was lowest for Consolidated (which bought none) and Natural and Texas Eastern (less than \$8 million each), and was highest for Southern (\$478.5 million), Columbia (\$480.0 million), and Transcontinental (\$605.3 million).

In terms of Section 107 costs as a proportion of total costs, data for the six pipelines for the first filing show a range from none at Southern to 11 percent at Transcontinental. Data for all 20 companies for the next two filings show overall proportions of 12 percent and 17 percent, respectively. The proportions for individual companies in the second filing were lowest (none) for the three pipelines with no purchases and were highest for Trunkline (28 percent), Colorado (29 percent), and Southern (41 percent). In the third filing, the proportions were lowest for Consolidated (none) and Natural and Texas Eastern (1 percent or less each) and were highest for Texas (32 percent), Colorado (33 percent), and Southern (40 percent).

Comparing results between the latter two periods shows an increase, in most cases, in total cost of Section 107 gas and that amount as a proportion of the total. For the six companies for which data are available for the first filing, the total cost in the later periods was higher in all cases. For the 18 companies which file semi-annually, total costs went up between the second and third filings in 16 cases, stayed the same in 1 case, and declined in 1 case.

Likewise, comparing proportions shows that for the six companies the percentages generally went up from the first period to the later periods. For the 18 companies the proportion increased in 12 cases, remained the same in 3 cases, and declined in 3 cases.

Finally, in the second filing, Section 107 gas constituted 5 percent or less of total costs for 10 companies, 6 to 24 percent for 5 companies, and 25 percent or more for 5 companies. In the third filing, it constituted 5 percent or less for six companies, 6 to 24 percent for eight companies, and 25 percent or more for six companies.

Table 3

COSTS OF SECTION 107 GAS PURCHASED

Pipeline Company	Cost of Section 107 Gas Purchased (in millions)			Section 107 Gas Costs as a Proportion of All Costs (in percent)		
	Filing (note c)			Filing (note c)		
	I	II	III	I	II	III
Cities Service	(a)	-	\$ 57.9	(a)	-	10
Colorado	\$ 18.6	\$184.1	258.7	4	29	33
Columbia	25.8	27.7	480.0	3	2	26
Consolidated	(a)	-	-	(a)	-	-
El Paso	(a)	152.9	267.1	(a)	8	12
Florida	(a)	62.6	49.4	(a)	25	20
Kansas-Nebraska	(a)	22.7	22.7	(a)	19	19
Michigan-Wisconsin	11.5	83.6	292.0	1	8	22
Natural	(a)	1.9	6.6	(a)	(b)	(b)
Northern	(a)	25.2	25.2	(a)	2	2
Northwest	(a)	-	8.4	(a)	-	3
Panhandle	(a)	22.5	27.5	(a)	3	3
Southern	-	454.9	478.5	-	41	40
Tennessee	(a)	21.6	201.8	(a)	1	9
Texas Eastern	(a)	(b)	7.9	(a)	(b)	1
Texas	(a)	180.8	316.4	(a)	21	32
Transcontinental	214.2	552.0	605.3	11	25	26
Transwestern	(a)	17.4	55.1	(a)	4	11
Trunkline	37.4	373.0	400.7	4	28	27
United	(a)	186.2	231.3	(a)	10	13
TOTAL	(a)	\$2,369.1	\$3,793.0	(a)	12	17

a/Not computed

b/Less than 0.5 percent

c/Filing I generally includes filings submitted during the second half of 1980; Filing II, the first half of 1981; and Filing III, the second half of 1981.

CASES INVOLVING DEREGULATED

NATURAL GAS: ISSUES RAISED AND STATUS

PGA filings by six companies ^{1/} were protested during 1981 because of issues relating to the purchase of deregulated gas. These six companies were among the first to include substantial purchases of such gas in their filings. Other filings--by these companies and others--including such gas have also been protested or have been suspended by FERC pending resolution of the six cases. The following pages discuss issues raised by protesters, company rebuttals to protesters, status of the cases, and a FERC policy statement relating to issues raised in these cases.

Because the companies did not present point-by-point rebuttals of the many protester charges, we summarize first all the issues raised by protesters and then all the company responses.

ISSUES RAISED BY PROTESTERS

In all six cases protesters objected to some aspect of the purchase of deregulated gas. (Other issues were raised in these cases, but they are not discussed in this report.) The protesters include local distribution companies, State and local governments, State public utility commissions, industry associations, and other interested parties.

Among the contested aspects of gas purchases are: (1) the relation between prices paid for gas and current prices for other fuels; (2) prices paid to pipeline affiliates; (3) purchases of deregulated gas in excess of current needs; (4) effect of deregulated gas purchases on pipeline customers; and (5) adequacy of documentation.

Many of the protests refer to the legal standard which must be satisfied in order for a pipeline to pass through purchased gas costs to its customers. Under the 1938 Natural Gas Act, prices can be passed through only if they are "just and reasonable." The 1978 NGPA amends the earlier act by providing, at Section 601(b)(1)(A), in essence, that any amount paid to a natural gas producer "shall be deemed to be just and reasonable" if:

^{1/}The six companies, and their cases, are: Colorado Interstate, docket number TA-81-1-32, filed on Aug. 15, 1980; Columbia, docket numbers TA-81-1-21, filed on Jan. 29, 1981, and TA-81-2-21, filed on July 31, 1981; Michigan-Wisconsin, docket numbers TA-81-2-48, filed on Mar. 31, 1981, and TA-82-1-48, filed on Oct. 1, 1981; Southern, docket number TA-81-2-7, filed on June 1, 1981; Transcontinental, docket numbers TA-81-1-29, filed on Jan. 29, 1981, and TA-81-2-29, filed on July 31, 1981; and Trunkline, docket number TA-81-1-30, filed on Jan. 14, 1981.

--the amount does not exceed the statutory ceiling for gas in that category, or

--there is no statutory ceiling for gas in that category because price controls were eliminated by that act.

A statutory ceiling now exists for all categories except deregulated gas (generally gas produced from a well which was drilled on or after February 1977 and located at a depth of more than 15,000 feet; and gas produced from geopressured brine, coal seams, or Devonian shale). However, in 1985 and 1987 substantial quantities of other gas will be freed from price controls.

The act further provides, at Section 601(c)(2)(B), generally that the Commission must allow a pipeline to recover any amount paid for natural gas if the price is "just and reasonable," as defined above, except "to the extent that the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds." Many protests refer specifically to this final phrase--"fraud, abuse, or similar grounds."

Deregulated Gas Prices Compared to Other Fuel Prices

Protesters in several cases charged that prices paid for deregulated gas were too high in relation to prices for other fuels. Typically, they cited prices for residual fuel oil, an energy source which competes with natural gas primarily in industrial uses, and asserted that residual oil prices should be used as a measure of the "market clearing price" for gas.

Prices Paid to Affiliated Entities

Another issue is the pricing of deregulated gas from affiliated entities, including the pricing of a company's own production. According to the NGPA Section 601(b)(1)(E), a pipeline company may not pay a price to its affiliate or for its own production that exceeds the price paid in comparable sales to a non-affiliated company. Protesters in several cases alleged violations of this test.

Purchasing More Gas Than Was Needed

Protesters in several cases objected to companies purchasing deregulated gas at high prices and--at the same time--selling gas to parties who were not regular customers. (FERC must approve sales to "off-system" customers, that is, those which the pipeline is not obligated to serve.) They stated that the companies had purchased deregulated gas that was not needed to meet customers' needs and then sold it off-system at a price below that paid for the deregulated gas.

Adverse Impact on Customers

Another issue raised is the adverse impact of deregulated gas on customers. It was claimed that purchases would raise overall prices, possibly leading to a large loss of industrial sales, which would create a burden on customers having no alternative fuel sources.

Inadequate Documentation

Some protesters raised the issue of the adequacy of information included in the filings. For instance, it was stated that a filing did not contain enough information for the Commission to determine whether NGPA Section 601 standards for passthrough of costs were met because the filing did not show whether the high prices paid resulted from the company's failure to bargain over price or failure to identify less expensive sources of supply.

COMPANY REBUTTALS TO PROTESTS

Companies involved in the six leading cases responded to protesters' allegations in several ways. In some instances, the companies cited specific reasons for purchasing deregulated gas. In other instances, the companies argued that the level of evidence presented by intervenors was inadequate to prove fraud or abuse on the part of the company. Additionally, the companies charged that protestors were attempting to reimpose price ceilings on deregulated gas. Finally, several companies objected to particular aspects of the hearing process itself.

Justification of Deregulated Gas Purchases

Some companies stated that they purchased deregulated gas to obtain adequate gas reserves for their customers. Company representatives further stated that reserves located below 15,000 feet (whose price is deregulated) contain larger volumes of gas than other types and therefore assure a long-term stable supply, that gas supplies would be available only to those companies willing to pay competitive prices, and that payment of those prices could hardly be considered fraudulent or abusive.

Inadequate Evidence of Fraud or Abuse

In response to charges that fraud, abuse, or similar grounds were involved in the pricing of deregulated gas, several companies countered by citing a lack of evidence or the speculative nature of the allegations.

Reimposing Price Ceilings

A pipeline also contended that protesters' complaints were an attempt to reimpose a price ceiling on deregulated gas. The company stated that reimposing a price ceiling would clearly contradict congressional intent to allow deregulated prices as an incentive for production.

The Hearing Process

Some companies objected to the PGA hearing process itself on the grounds that it was prejudicial to the companies whose filings were being protested. In general, the companies argued that if deregulated gas contracts of some companies were to be made available to protesters, then the same information should be required of all pipelines. To do otherwise, according to the companies, would jeopardize their competitive position in the industry and weaken their bargaining position with suppliers.

THE REVIEW PROCESS--STEPS INVOLVED AND CURRENT STATUS OF SIX LEADING CASES

FERC's review of a filing may involve numerous steps and may take many months to complete. The duration depends on the components of the review process itself, the nature of the case, and other factors. The information presented below outlines the review process and describes the current status of the six leading cases.

Steps in the Review Process

A pipeline's PGA filing generally passes through several stages of review if it is not contested and many stages of review if it is contested. Because of the number of stages and other factors, many months may elapse in some cases before a decision is made.

With respect to the six leading cases, for example, through the end of February 1982, an average of more than 13 months had passed since the dockets were filed in the five open cases; one case has been completed. The Colorado case had been under review for the longest period--18.5 months--while the Trunkline case was completed in 6 months.

A pipeline company wishing to adjust its passthrough of purchased gas costs must submit a PGA filing by a specific date.

When a filing is received, the Commission places a notice in the Federal Register inviting intervenors to respond. FERC staff has 30 days to review a PGA filing before it goes into effect. During that period the staff reviews the filing to ensure that gas costs are accurately calculated and in accordance with NGPA ceiling prices and applicable rules and regulations. They also review the filing to determine whether rebates or surcharges due from prior periods are adjusted accordingly.

If there are no protests and if FERC staff--in its preliminary review--finds no serious problems and raises no serious questions about the filing, the Commission typically approves the filing and the new prices go into effect. According to FERC officials, most PGA filings are approved subject to conditions. These conditions often involve a conference between pipeline representatives and FERC staff, an audit of the company, or provision of additional data to FERC staff for review.

However, if outside parties protest the filing and the Commission accepts the protest or if FERC staff--in its preliminary review--finds serious problems or raises serious questions about the filing, the filing can be "suspended." This allows the new prices to go into effect but means that they are subject to refund based on the outcome of the proceeding.

The Commission generally assigns an administrative law judge to preside over the case and establish procedural dates. Next, the law judge holds prehearing conferences to determine and clarify the issues involved in a case. When parties to the case and the law judge agree that sufficient information has been obtained, the law judge sets dates for either pretrial statements or written testimony to be submitted prior to a formal hearing. Following a hearing and submission of further briefs by the parties, the law judge renders a decision. The decision is then reviewed by the Commissioners, who partially or entirely uphold or overturn it. A party to the proceeding can ask the Commission to reconsider its decision or can appeal to the courts.

Although most PGA filings are normally approved subject to conditions, almost all filings submitted over the past year have been suspended in part due to their inclusion of deregulated Section 107 gas. The pricing of Section 107 gas has been objected to by a number of outside parties in six major PGA filings. As a result, FERC is withholding final approval of similar filings pending resolution of the six precedent-setting cases.

Several factors can affect the rate at which these stages are completed. These include late petitions to intervene, the amount and type of evidence brought into the case, availability of certain types of evidence to outside parties, and the Commission's procedural rules.

The duration of a proceeding may be lengthened when protesters file their petition to intervene late or when protesters need to compile additional evidence to justify a hearing. In the Colorado case, for example, the first protesters did not file a request to intervene until January 29, 1981, 5 months after the docket was filed, and they did not submit a detailed statement of their objections until June 19, 1981, about 5 months later.

Further, access to company information may be sought by protesters and resisted by companies. Law judges in these cases have considered them as proceedings of "first impression," allowing broad discovery efforts. This may entail requests for a considerable amount of company information. For example, protesters have requested company contracts with suppliers of Section 107 gas and details of company purchasing policies, as well as other documents. As noted above, companies have resisted requests that they furnish details of contracts and related information. Protesters may then need considerable time to review the information provided.

Even when such information is supplied, companies may try to limit access to it. They may try to obtain a "protective order" which sets limits on who can review certain documents, where, and whether such information can be disseminated. Time elapses while the need for such an order, and its terms, are discussed.

Finally, the Commission's procedural rules can affect the duration of a case. Parties are permitted to respond to motions and briefs filed by other participants. In addition, parties involved in Commission proceedings have the right to request reconsideration of orders, decisions, suspension orders, information requests, and other official rulings made by the presiding law judge. Protesters, company representatives, and other participants in PGA and other proceedings may also petition for rehearings.

Current Status of Six Leading Cases

Of the six leading cases, one has been completed because the protesters withdrew their objections, and the other five have been under review for varying periods of time and are at various stages in the review process. Because the Commission has not ruled before on some of the issues presented by these cases and because of the many factors that can affect the duration of a proceeding, it is not possible to estimate reliably when these ongoing cases will be completed. Presented below is a summary of the major procedural dates in each of the six cases, as of March 19, 1982.

Colorado Interstate Gas

Colorado submitted a filing on August 15, 1980, which was suspended on September 29, 1980. Prehearing conferences were held on May 12 and September 2, 1981. Written testimony and pretrial statements were submitted between July 28, 1981, and August 5, 1981. A formal hearing was held between December 1 and December 3, 1981. Initial briefs, which summarize information presented in the hearing and substantiate a party's position, were submitted January 25, 1982. Reply briefs were submitted February 16, 1982. The next step is a decision by the administrative law judge.

Columbia Gas Transmission Corporation

Columbia submitted a filing on January 31, 1981, and a subsequent one on July 31, 1981. The filings were suspended on February 28, 1981, and August 31, 1981, respectively, and on the latter date both filings were consolidated into one proceeding. Prehearing conferences were held on March 24, June 25, September 24, and October 21, 1981. Testimony and pretrial statements were submitted between December 18, 1981, and January 26, 1982. Hearings were held between February 16 and March 22, including a field hearing in Columbus, Ohio, on March 18. Initial briefs from all parties are due May 21, and reply briefs are due June 21.

Michigan Wisconsin Pipe Line Company

Michigan-Wisconsin's proceeding also involves two filings. PGA dockets filed on March 31 and October 1, 1981, were suspended on April 30, 1981, and October 30, 1981, respectively. On the October date the filings were consolidated into one proceeding. Prehearing conferences were held on May 29 and July 21, and supplemental statements were submitted during the first week of March, 1982. A hearing date has not been set.

Southern Natural Gas Company

Southern's filing of June 1, 1981, was suspended on June 30, 1981. A prehearing conference was held on September 30, 1981. Discovery of information is currently taking place and a hearing date has not been set.

Transcontinental Pipe Line Corporation

Transcontinental's filings submitted on January 29, 1981, and July 31, 1981, were suspended on February 28 and August 31, 1981, respectively. On August 31 the filings were consolidated. Prehearing conferences were held on March 27, July 14, and December 10, 1981. FERC staff filed a motion on February 5, 1982, requesting that procedural dates be set. Applications to take depositions were filed by two intervenors on March 8, 1982; the company responded on March 15, 1982.

Trunkline Gas Company

Trunkline's filing on January 14, 1981, was suspended on February 28, 1981. A prehearing conference was held on March 30, 1981, and testimony and pretrial statements were due between January 23 and February 9, 1981. A hearing was held on June 6, 1981. On July 22, 1981, the intervenors withdrew their protest, citing (1) special facts and situations involved in the case, (2) their limited resources for Federal proceedings, and (3) other alternatives for them to present their concerns to FERC. The law judge accepted their withdrawal, and this proceeding was officially terminated on July 23, 1981.

POLICY STATEMENT ON "FRAUD, ABUSE, AND SIMILAR GROUNDS"

On February 4, 1982, FERC issued a policy statement 1/ on its interpretation of "fraud, abuse, or similar grounds" (the fraud standard), as contained in NGPA Section 601(c). FERC issued the policy statement as guidance for the disposition of proceedings where the fraud standard is an issue. 2/ Earlier, the Commission had decided to allow law judges in PGA hearings to interpret this standard, but reversed itself, stating that it was the duty of the Commission to interpret the meaning of "fraud, abuse, or similar grounds."

According to NGPA Section 601(c), the Commission may not deny any interstate pipeline passthrough of any natural gas purchase price unless the Commission determines that the amount paid was due to "fraud, abuse or similar ground." Intervenors have argued that the fraud standard, because it is the only means to deny passthrough, is broad enough to include imprudent gas purchase practices.

The Commission, in its review of the NGPA and its legislative history, studied the specific application of the fraud standard and its relation to the Natural Gas Act "just and reasonable" standard, and the congressional intent relating to these issues. NGPA Section 601 provides that producer-pipeline wellhead transactions are considered to be just and reasonable if the price does not exceed the maximum price authorized by Title I or if there is no ceiling for that category, except to the extent that prices are excessive due to "fraud, abuse, or similar grounds."

1/Federal Register, Vol. 47, No. 29, Feb. 11, 1982, pp. 6253-63.

2/The Commission stated that the policy statement does not have the force of law but is an articulation of the Commission's tentative intention which will be followed unless circumstances demonstrate the policy to be inappropriate.

The Commission stated that there is nothing within the NGPA nor in its legislative history enabling them to disallow pass-through of prices due to imprudence. The Commission concluded that the fraud standard does not include imprudent business judgment about how much a pipeline should pay for gas. Further, the Commission viewed the inclusion of imprudence as an indirect or backdoor attempt at controlling deregulated gas prices, contrary to the intent of the Congress. The Commission further concluded that the fraud standard was, as it appeared to be, a device to prohibit charges falsely levied.

For reasons discussed within the policy statement, the Commission, therefore, said that it intends to limit the fraud standard to consideration of whether the price paid by an interstate pipeline is excessive due to misrepresentation. The Commission determined that for the issues of "fraud, abuse, or similar grounds" to be considered in a Commission proceeding, an intervenor must allege that:

- (1) for fraud, the interstate pipeline, any producer which made a first sale to the pipeline, or both acting together, made a fraudulent misrepresentation or concealment;
- (2) for abuse, a negligent misrepresentation or concealment in disregard of a duty; and
- (3) for similar grounds, an innocent misrepresentation of fact.

In addition, the intervenor must also charge that because of a misrepresentation of fact, the price paid by the interstate pipeline to the producer for the first sale was higher than it would have been absent the misrepresentation.

On March 8, 1982, the Process Gas Consumers Group and the Wisconsin Public Service Commission applied to FERC for a rehearing (Docket PL 82-1-000) concerning this FERC policy statement. They asserted that the fraud standard should not be limited to misrepresentation.

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