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DRAWBACKS OF FEDERAL NATURAL GAS REGULATION

J. Evans Atwell*

I. INTRODUCTION

Before I discuss with you several areas where I believe government regulation and, in particular Federal Energy Commission regulation, is actually hurting more than it is helping, I think in fairness I should recognize certain handicaps that this new Commission starts out with. I think no child of Congress ever come into the cruel, cold regulatory world with more handicaps than the Federal Energy Regulatory Commission (FERC).¹ For starters, there is its given name, the Federal Energy Regulatory Commission. The Commissioner is careful to point out to you that he was going to refer it to as the F-E-R-C. I don't care how hard they try, it is going to be known to those of us who practice before it, and those of us who are regulated by it, as "the FERC." You would think that, coming from the Nixon years when we had the Committee to Re-Elect the President, which became CREEP, the incumbent administration would be more sensitive to the acronyms that develop from the use of certain names.

In any event the new Commission has been really given vastly expanded regulatory authority, and it has not just inherited the responsibilities of the Federal Power Commission. However, having been given this expanded authority, it has not been given any significantly additional personnel. For example, the FERC inherited only thirteen people from the Interstate Commerce Commission to assume the tremendous burden of regulating oil pipeline rates and valuations. In addition, the FERC has inherited from the Federal Power Commission

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1. Department of Energy Organization Act of 1977, Pub. L. No. §§ 401-407, 91 Stat. 582-87 (to be codified at 42 U.S.C. §§ 7171-7177).

a backlog of *six thousand cases*. The problem has been compounded by the fact that, during the last six months of its existence, the Federal Power Commission had an attrition rate of twenty percent. So what we have now is about 119 or 120 vacancies on the Commission staff. The new Commission really starts out in the world with two strikes against it; therefore the FERC has asked for increased personnel in the latest budget. I think the increase that was approved by Secretary Schlesinger was in the neighborhood of 525 additional employees, although it appears they may only get 200. One of the real problems is that the FERC does not have adequate personnel to handle the caseload that it is charged by law with undertaking and handling. That is one thing that we have got to remember: it is not a matter of discretion with these agencies, with the FERC, as to whether they regulate or don't regulate. That is something the courts have told them repeatedly that they have to do; so it is up to them to have to perform the function in accordance with the particular laws.

II. ADMINISTRATIVE DELAY

This brings me to the first area where I think that governmental regulation, and in particular the Federal Power Commission, has been hurting more than it has been helping. That is the question of delay. I do not speak of delay as a matter of weeks or months, but I speak of interminable delays. Delays that go on for so long that they kill projects that are clearly in the public interest; delays that go on for years so that there is no economic certainty, for either the regulated industries or the consuming public.

I might just mention two examples. In the early 1960's, I was involved in a project whereby the then Humble Oil & Refining Company, now Exxon, was going to sell over six trillion feet of gas on a warranted basis to the interstate market from the King Ranch in south Texas. They wanted eighteen cents per thousand cubic feet (mcf) for the gas, and that price was going to virtually level over twenty years. But the Commission was then trying to force everyone to take sixteen cents. We had these prolonged and protracted hearings that went on seemingly forever. Exxon finally just got sick of it and said to hell with them—we are going to build our own thirty-six inch line to Houston and sell the gas there. That is what they did, and the interstate market lost six trillion cubic feet of gas because of delay.

Another example and one that I am very fond of is a case which commenced in 1957 called the Rayne Field case which involves a field

over in south Louisiana and the rates that should have been charged. I can tell you right now that the Rayne Field case is still alive and is still going. We have been to the Supreme Court of the United States three times, we have gotten four decisions by courts of appeal, and we have gotten nine decisions by the Federal Power Commission. We have pending before the Commission at this time a settlement under which the producers would refund approximately sixty million dollars. But at best the case has gone on for over twenty years, resulting in tremendous economic uncertainty. I think that something has got to be done to eradicate this type delay in the regulatory process.

Now it really has become a custom for each new chairman of the Federal Power Commission or the now Federal Energy Regulatory Commission, to pronounce that he is going to revolutionize the procedures that have heretofore been followed; he is going to cut the Gordian knot and expedite the decisional process. Thus Charles Curtis, the new chairman of the Federal Energy Regulatory Commission, has recently made several talks in which he has made that very point. I certainly do not for a minute doubt his sincerity that he is going to do everything he possibly can to streamline the regulatory process. But I do think the problem is that the decisional process has to be conducted within the confines of various and sundry laws, such as the Administrative Procedures Act² and basic due process, and it takes a long time. In short I think that delay is inherent in the regulatory process. I think it is a serious question as to whether the benefit to the public of certain parts of the regulatory process are commensurate with the burden. I really do not think there is any solution. Chairman Curtis has suggested that we try to go to generalized guidelines. Well, the old Federal Power Commission went to generalized guidelines when it went to the national rate procedures,³ but what do we have? We have biennial decisions, whereby the Commission undertakes to set new rates for every two years. By the time the new rates come out, the two years have expired. As you know, we have had a recent decision for the years 1975 and 1976 by the United States Supreme Court denying certiorari, in which Opinion 770-A became final. But here we are in 1978, and the Commission has already commenced another biennial proceeding for the years 1977 and 1978, and there is no way that that decision is going to be rendered before 1978 is past, thus once again the

2. 5 U.S.C. §§ 1001-1011 (1967).

3. FPC opinion 770-A 41 Fed. Reg. 50,199 (1976); FPC opinion 699-H 18 C.F.R. § 2.56a (1976).

decision is going to be antiquated. It is a very serious problem, and I don't mean by that to say that we shouldn't try to minimize the delay. I just simply point out that I think delay is a very serious factor in the regulatory process that has to be weighed as to whether the regulations themselves are justified.

III. BURDENSOME REPORTING REQUIREMENTS

The second area that I think government is hurting more than helping is the paper chase. In recent years, governmental agencies have promulgated one form after another demanding that industry, and I do not mean big industry—I mean relatively small businessmen, fill out forms incessantly. I can tell you that one of the most guilty culprits is the Federal Power Commission and, I presume its successor, the Federal Energy Regulatory Commission. People are spending tremendous sums of money and tremendous amounts of time to fill out these forms. There is Form 40 for reporting your reserve data. There is Form 64 for reporting expenditures for exploration and development. You have form this and form that. The medium and smaller producers are really not set up to handle this. The old Federal Power Commission required these forms to be filed by even the smallest producers, those that sold approximately 200,000 McF in interstate commerce each year. The new Commission has tried to ease that burden by making the cutoff point 1,000,000 McF a year. I do know that they have a particular task force, both in the FERC, and in the Department of Energy itself, dedicated to streamlining this never ending request for more and more information. But I would hope that our past experience is not indicative of what is going to happen in the future, because we have seen it grow despite the protestations of the regulated. Obviously, government has to have and is entitled to have a certain reasonable amount of data, but I think they have clearly gone beyond the pale, particularly in the energy area, resulting in a tremendous duplication and overlap. The Federal Trade Commission is always trying to get information in this area in competition, with the Federal Power Commission or the FERC. Something has got to be done to confine the paper chase within reasonable bounds.

IV. ADMINISTRATIVE INFLEXIBILITY

The third area that I want to focus on is the law's prevention of the natural gas industry from exercising flexibility to meet gas shortage problems. For example, in the southwestern United States in the win-

ter we sometimes have a temporary surplus of gas that is used in the summer to generate electricity for air conditioning purposes. You might say that our peak use of natural gas comes in the summer because of the air conditioning situation, whereas the peak use of gas in the northern United States comes in the winter. Why shouldn't there be some type of flexible arrangement whereby the intrastate pipelines could sell that surplus gas on a temporary, short-term basis, to meet the needs of the North. There are sixty day arrangements which have proven to be helpful to a certain degree, but they do not reach the total available excess supply. I think that we need to have legislation that will permit that to be done, and I think that the industry is clearly in the best position to work this out, rather than having an energy czar to try to direct allocation of gas.

V. INTERSTATE DEDICATION PROBLEM

A fourth area where I think government may be hurting more than helping is the position that the Federal Power Commission, and now the FERC, has taken in various cases about land and acreage being dedicated to interstate commerce. They claim that once it is dedicated to interstate commerce, it is always dedicated to interstate commerce. A case here in Oklahoma involves a French company called Aquitaine that dedicated leases throughout a million acre area. They drilled a few of those leases and started delivery of gas in interstate commerce. As to certain other leases, they never drilled and let them go. Four or five years later, someone else came along and took a new lease on the same land previously covered by these expired undrilled leases which were let go. They drilled and found a new gas discovery. The Federal Power Commission came in claiming the land was still dedicated to interstate commerce. The big problem is that, if that is true, we are in a situation where the taker of an oil and gas lease never knows whether it has been dedicated because most natural gas contracts are not recorded. I think that this will have a deleterious effect on the exploration for and development of additional gas supplies onshore. I have made that argument in the courthouse and before the Commission, and I am afraid that, at least before the Commission, it has been rejected. Although in the courthouse we seem to be doing somewhat better. I think that it is a bad policy from the Commission's standpoint regardless of whether it is within the Commission's authority under the Emer-

gency Natural Gas Act.⁴

That brings us to the pricing situation. The new Commission has really deferred taking any action on pricing until it sees what happens in the legislative arena. As previously noted, we have before the new Commission a pending proceeding to set new national rates for the years 1977 and 1978. The evidence that has been submitted in those cases would indicate a rate between \$2.00 and \$2.60 per McF. On the other hand, a group that calls itself the Consumer Coalition has filed a petition with the Commission claiming that even the rates recently approved in Opinion 770A are too high. They claim further that this Commission should immediately start regulating intrastate rates because they have an adverse effect on the supply of gas available to the interstate market. That petition has been put on the shelf pending action by Congress.

VI. LEGISLATIVE ACTION

I now want to turn to the legislative situation, because I think that, if and when Congress passes a National Energy Act, the natural gas portion of that legislation is going to determine to a great extent the future role that the FERC is going to play in maximizing the supply of available natural gas. I presume that each of you is aware that we have had a legislative impasse on the National Energy Act due to the fundamental differences in the natural gas legislation that was passed by the House of Representatives⁵ and the corresponding legislation that was passed by the Senate.⁶ Generally speaking, the House bill would extend federal regulation to all sales of gas, interstate and intrastate. The House bill would provide a ceiling price of \$1.75 per McF for new gas, and it had a narrow definition of new gas. The House bill stands for more regulation, not less regulation. On the other hand, the Senate passed legislation sponsored by Senator Pearson of Kansas and Senator Bensten of Texas which would eliminate FERC price regulation of new onshore gas after two years, and would terminate such regulation of new offshore gas after five years. This bill has a much more liberal definition of new gas and more liberal pricing provision. Both the House and the Senate passed its respective version of this legislation many months ago, and a joint committee was set up to try to reconcile the differences. That joint committee started meeting early in Decem-

4. 15 U.S.C. § 717-717w (1976).

5. H.R. 6831, 95th Cong., 1st Sess. (1977).

6. S. 1469, 95th Cong., 1st Sess. (1977).

ber, and they were able to reconcile many differences in the National Energy Act, until they got to natural gas. Immediately there began to be a lot of political posturing, and this proved to be a very emotional and almost explosive issue. The acrimony culminated in President Carter making remarks that were less than complimentary of industry representatives advocating deregulation. I think since that time things have cooled down considerably, and we have seen a series of compromises proposed and fail. However, it appears that the parties are getting closer and closer together. I believe that in the relatively near future they are going to reach agreement on the natural gas legislation.

Before giving you my best guess as to where the conferees are going to come out on the major points of such legislation, I think I might mention two relatively unknown factors that probably will ultimately play a significant part in making a compromise possible. First, even though the Senate had in effect passed deregulation, nine out of the eighteen conferees they appointed were opposed to deregulation. So the Senate part of the committee was split. That really made it kind of difficult, if not impossible, for negotiations to be conducted because the Senate conferees really did not have a firm position. But during the course of these negotiations, Senator Lee Metcalf of Montana, one of the Senators opposed to deregulation, died. That made it nine to eight, and needless to say the nine would not permit Senator Metcalf to be replaced. Therefore, there was a nine to eight majority in favor of deregulation. They had a more definite position, even though there was still a split.

The second factor is very interesting. In January of this year, the National Association for the Advancement of Colored People, in a completely unexpected position paper, advocated deregulation. The Carter people tried to play it down, but I think it was a shock to them. I also think the White House got the message that its entrenched position against deregulation needed reevaluation.

I want to give you my best guestimate as to where we might come out on some of the principal features of any new natural gas legislation. Clearly, the big political issue is whether we are going to have more or less federal regulation of natural gas prices. The Carter people and the House want more regulation, and the Senate, at least the majority of the conferees, want to have deregulation. It is a hot political issue, particularly for a politician from a producing state. He could hardly afford to vote for a bill calling for more regulation. The compromise that they apparently have come to is one under which we will have

more regulation, and then less regulation, that is we will have regulation of both interstate and intrastate sales for a limited period of time. They call this solution light at the end of the tunnel. After Viet Nam, I would have thought they would have come up with a better phrase. This means that for those that favor deregulation, there is light at the end of the tunnel. However, the people who are advocating regulation say we are likely to have a terrible situation develop when regulation ceases. May I say it is regulation only of new gas that is going to cease. Regulation of old gas will continue. From the compromise, it appears that the legislation will give the President the authority to reimpose controls during a two-year period after deregulation, if the price for new gas during the preceding six months exceeds the ceiling price that would have been in effect for such new gas if the controls had continued. In the political parlance this is called the safety net for consumers in the event that deregulation results in excessive prices.

There appears to be close agreement as to the ceiling price that would be put on new gas. It appears the new gas price will start out at \$1.84 and will escalate annually by an inflation factor, computed either from the Consumer Price Index, or the gross national product inflator, plus either three or four percent. What the escalator will really be is inflation plus three or four percent, so that a seven or eight percent inflation rate would yield a ten or eleven percent annual increase.

The definition of new gas has given and continues to give some problems. I think everyone seems to agree that new onshore gas should be defined as that which is sold or commercially produced for the first time on or after April 20, 1977, the date the legislation was introduced, from an existing reservoir from which gas was not produced in commercial quantities before that date. That definition is fairly broad and takes into account both new discoveries and gas that is in the ground now that has not been connected. One catch is that if the gas was wrongfully withheld it would not qualify, and what constitutes wrongful withholding is another unanswered question. Offshore there is more of a problem. The people favoring regulation say that producers in the offshore area are fixed in interstate commerce and are subject to regulation in any event, and are not entitled to the same definition as onshore gas. They have advocated that the only offshore gas that could qualify as new gas would be gas that was drilled on leases that were acquired on or after April 20, 1977. There has been a continuing attempt to expand that definition to include newly discovered reservoirs under older leases. Where we are really going to come out

offshore is difficult to determine at this time, but I believe there is going to be some type of newly discovered reservoir provision, and the determination of whether it is a new reservoir is going to be by a state agency or the United States Geological Service, probably subject to the right of the FERC to overrule that determination.

One of the most hotly contested parts of the bill is the allocation authority Senator Jackson and his adherents advocate that the President must be given the absolute power to take gas from one state and give it to another. Needless to say, the people in Texas, Oklahoma and other states that produce and consume a great deal of gas oppose this, supporting no allocation authority. I feel that it is gas that we found, bought, relied upon and built factories on, and we cannot afford to have our operations conducted in a manner which could result in a sudden loss of that gas. It appears that the compromise is going to result in a limited allocation authority. It will be limited to situations where there is a declaration of emergency, for the length of the emergency, and it will also be limited strictly to gas that is free from boilers. That seems to be the compromise that the parties are working toward, and I believe they will finally reach.

There are numerous other provisions in this bill, and I might just touch on two or three. As to existing intrastate sales that are now being made, and many of them are made at prices higher than the \$1.84, if the price is higher than the \$1.84 you can continue to collect that higher price, and that price can continue to escalate by the inflation factor, but not the three or four percent bonus. If and when the price of new gas catches up the ceiling price for these existing intrastate sales will move in tandem with the new gas price.

Secondly, if the intrastate price is below the \$1.84 at the present time, then you could escalate in accordance with your contract until you reach the ceiling price for new gas, and then the price would move in tandem with it.

There is another big issue, and that is what happens when we have so-called rollover contracts. If you are in the interstate market and your price is down at twenty or thirty cents, you will be entitled to go up to fifty-five cents and that fifty-five cents would rise with the inflation factor. However, if you are in the intrastate market and your price is a low one, anywhere below a dollar, you get to go up to a dollar, and again the dollar ceiling would be subject to escalation by the inflation factor. Thus in the interstate market, if your price at the end of your contract was above the fifty-five cent minimum, you would

keep that price and keep on going with the inflation factor; while in the intrastate market, if your price was above a dollar when the contract expired, you would keep the price that was in existence and that price would continue to escalate with the inflation factor.

I think they are going to provide special prices for so-called high cost gas. They are talking about a price of \$2.00 to \$2.09 subject to an escalation equal to the inflation factor plus four percent for gas that is produced from Devonian shale, geopressurized brine and coal seams. But the interesting thing is that so far they also define high cost gas to include gas that is produced from wells drilled to a depth greater than 15,000 feet. I know in certain parts of Oklahoma that can be extremely important. They are also apparently going to make a special price provision for so-called stripper well gas. There is some chance that they could actually deregulate that, but probably they will also allow it a price of \$2.00 to \$2.09. Stripper well gas is gas produced in a well that produces less than 60 McF per day on an average. I presume there will be some base period-production control level which will require a computation of how much gas you have produced.

Let me finish the caveat that even if they get over the natural gas hurdle, I am afraid that we still have to deal with crude oil equalization tax which may prove to be just as difficult if not more difficult to solve. But I do say that I earnestly believe that it is time we had a National Energy Policy. It has to be a realistic one, and I think that if this Congress does not pass one, it will be bad for this country in many ways.