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The Definition of Abuse under the Natural Gas Policy Act of 1978: Office of Consumers' Counsel v. FERC

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THE DEFINITION OF ABUSE UNDER THE NATURAL GAS POLICY ACT OF 1978: *OFFICE OF CONSUMERS' COUNSEL v. FERC*

I. INTRODUCTION

To encourage increased gas production, Congress partially deregulated the natural gas industry when it passed the Natural Gas Policy Act (NGPA) in 1978.[1] Section 601(c) of the NGPA guarantees passthrough of gas acquisition costs by pipelines to customers, providing that any amount paid to producers shall be deemed "just and reasonable" if the gas is deregulated or if the price paid does not exceed the ceiling price.[2] The Federal Energy Regulatory Commission (FERC or Commission) may not deny passthrough unless it determines that the amount paid to producers was "excessive due to fraud, abuse, or similar grounds."[3] The Commission has held that "abuse" means an acquisition policy which shows a reckless disregard of the pipeline's fundamental duty to provide service at the lowest, reasonable rate *and* has a "significant, adverse effect" on the customer or consumer.[4] Both pipelines and consumer groups challenged this interpretation of abuse in *Office of Consumers' Counsel v. FERC*.[5]

Editor's Note: The editor thanks Christie Day, Editor in Chief of the ENERGY LAW JOURNAL, for her assistance in preparing this note for publication.

1. Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351 (codified at 15 U.S.C. §§ 3301-3432 (1982)).

2. 15 U.S.C. § 3431(c)(2) (1982). In addition to some types of gas being totally deregulated, the Commission's ratemaking authority over first sales of other types of natural gas was abrogated by NGPA provisions calling for "maximum lawful prices" to act as ceilings. 15 U.S.C. §§ 3312-3319, 3431(a)(1) (1982). A first sale of natural gas is defined under the Act as gas that was not committed or dedicated to interstate commerce when the NGPA was enacted. 15 U.S.C. § 3431(a)(1) (1982).

"Passthrough," a term of art in the natural gas industry, is a provision of a price control law or regulation permitting certain increased costs to be "passed through" to customers by allowable price increases. McCulloch Gas Transm. Co. v. Public Serv. Comm'n, 627 P.2d 173, 180 (Wyo. 1981). It is significant that the amounts paid be deemed "just and reasonable" because rates subject to regulation under the NGA are unlawful unless they are "just and reasonable." 15 U.S.C. § 717c(a) (1982). *See infra* note 32 and accompanying text.

3. 15 U.S.C. § 3431(c)(2) (1982).

4. Columbia Gas Transm. Corp., 26 F.E.R.C. ¶ 61,034 at 61,100 (1984) [hereinafter *Opinion No. 204*]. Normally a customer is a utility company that purchases gas directly from a pipeline and a consumer is one who purchases from the the utility.

5. 783 F.2d 206, 211-12 (D.C. Cir. 1986) [hereinafter *Consumers' Counsel*]. Petitioners were

II. STATEMENT OF THE CASE

A. *Background: The Regulatory Framework*

Natural gas in interstate commerce is regulated by the FERC under authority granted in the Natural Gas Act of 1938 (NGA),[6] and the NGPA.[7]

Section 4 of the NGA governs the rates that a pipeline may charge.[8] In practice, a pipeline sets its rates using any one of a variety of ratemaking methods.[9] The Commission then uses a cost-of-service analysis, which takes into account the expenses of acquiring and transporting gas and a reasonable rate of return for the pipeline,[10] in determining whether the rates satisfy the "just and reasonable" standard mandated by section 4 of the NGA.[11] If a rate increase is sought, the pipeline bears the bur-

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Columbia, intervenors (Interstate Natural Gas Association of America, Texas Eastern Transmission Corp., Transwestern Pipe Line Co.), and *amicus curiae* El Paso Natural Gas Co., who contended that the Commission's interpretation of abuse was too expansive. Other petitioners protested that the Commission's standard for abuse was too narrow. This group consisted of the Office of Consumers' Counsel, State of Ohio, Associated Gas Distributors, Baltimore Gas and Electric Co., Cities of Charlottesville and Richmond, Virginia, Citizen/Labor Energy Coalition, the Process Gas Consumers Group, and Public Service Commission of the State of New York. The Georgia Industrial Group, the American Iron and Steel Institute, Maryland Peoples' Counsel, Office of Consumer Advocate for the Commonwealth of Pa., and UGI Corporation filed intervenors' briefs supporting these petitioners. *Id.* at 211-12 nn.1-2.

6. 15 U.S.C. §§ 717-717w (1982). One of the purposes of the NGA was to "protect customers against exploitation at the hands of natural gas companies." FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944). Originally, the Federal Power Commission (FPC) only regulated interstate pipelines, but in 1954 the Supreme Court extended the Commission's regulatory authority under the NGA to sales by producers to interstate pipelines. Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954).

7. 15 U.S.C. §§ 3301-3432 (1982). In enacting the NGPA, it was Congress' intention to alleviate gas shortages and stimulate the natural gas industry. Ringleb, *The Natural Gas Regulatory Dilemma: A Market Solution, Another Compromise, or the Status Quo?*, 6 J. ENERGY L. & POL'Y 107 (1985). For background on the NGPA, see Hollis & Strohl, *Squaring the Circle: Implementing the Agricultural Use Exemption from Incremental Pricing Under the Natural Gas Policy Act*, 15 NAT. RESOURCES LAW. 419 (1981); Means, *Issues in the Debate over Natural Gas Decontrol*, PUB. UTIL. FORT., Oct. 28, 1982, at 18; Mogel & Mapes, *Assessment of Incremental Pricing Under the Natural Gas Policy Act*, 29 CATH. U.L. REV. 763, 774-80 (1980); Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 HARV. L. REV. 345 (1983). In 1977, Congress passed the Department of Energy Organization Act, which eliminated the FPC and created the FERC. Pub. L. No. 95-91, 91 Stat. 565 (codified at 42 U.S.C. §§ 7101-7375 (1982)).

8. 15 U.S.C. § 717c (1982).

9. *See infra* note 14.

10. Brief for Respondent FERC at 3, Office of Consumers' Counsel v. FERC (D.C. Cir. 1986) [hereinafter Brief for Respondent]. Gas acquisition costs are averages of the costs of gas purchased from many sources. High-cost gas can be "rolled-in" with its "cushion" of low-priced gas. *Consumers' Counsel*, 783 F.2d at 213 n.3.

11. 15 U.S.C. § 717c(a) (1982). Under section 4 of the NGA, rates are charged through a cost-of-service filing (this filing is sometimes referred to as a full-scale section 4 review; *see infra* note 15). Thereafter, if a pipeline's purchasing practices are found to be "imprudent" the Commission is empowered to adjust the pipeline's rates as being unjust and unreasonable, even though the rates were

den of proof that the requested rates are "just and reasonable." If a party or the Commission wants a rate changed, that party must show that the present rate is unjust and unreasonable.[12] Section 5 of the NGA gives the Commission the authority to hold hearings to determine if rates, rules, regulations, practices, or contracts are unjust and unreasonable. If the Commission finds that they are unjust and unreasonable, it may reform them.[13]

In 1972, the FPC established the Purchased Gas Adjustment (PGA) alternative for adjusting pipeline rates.[14] Rather than going through a full section 4 review, interstate pipelines "may submit a special 'purchased gas adjustment' filing biannually to adjust their rates for increases or decreases in the cost of gas they purchase from suppliers."[15] The pipeline must file for a full section 4 review after three years.[16]

When the NGPA was passed in 1978, it changed the regulatory structure of natural gas. To encourage increased gas production, Con-

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originally found to be just and reasonable in the absence of imprudent practices by the pipeline. *See* 15 U.S.C. §§ 717c-717d (1982); *Phillips Petroleum*, 347 U.S. 672; Columbia Gas Dev. Corp. v. FERC, 651 F.2d 1146, 1148-49 (5th Cir. 1981). Imprudence under the NGA automatically renders rates unjust and unreasonable. Panhandle Eastern Pipeline Co. v. FERC, 777 F.2d 739, 743 (D.C. Cir. 1985). *See also* Natural Gas Pipeline Co. of America v. FERC, 765 F.2d 1155 (D.C. Cir. 1985) (while imprudence will automatically render rates unjust and unreasonable under the NGA, rates may be declared unjust and unreasonable for other reasons even if the pipeline acted prudently).

12. 15 U.S.C. § 717c(e) (1982).

13. 15 U.S.C. § 717d(a) (1982).

14. *See* Purchased Gas Cost Adjustment Provision in Natural Gas Pipeline Companies' FPC Gas Tariffs, Order No. 452, 47 F.P.C. 1049 (1972); *see also* Order No. 452-A, 47 F.P.C. 1510 (1972). Past methods used by the Commission to adjust rates have included decreasing the rate of return to the pipeline or changing the distribution of fixed costs by increasing the amount of fixed costs assigned to the demand component of the rates for the purpose of responding to competition or encouraging more efficient use of a pipeline's facilities. Consolidated Gas Supply Corp. v. FPC, 520 F.2d 1176, 1181 (D.C. Cir. 1975). Normally a pipeline's rates consist of a demand charge and a commodity charge. "The demand charge is usually a fixed rate billed on the basis of the maximum volume of gas a customer is entitled to purchase and on a given day, while the commodity charge is billed on the basis of the actual units of gas taken." *Consumers' Counsel*, 783 F.2d at 217 n.23. The commodity charge is calculated to recover all the variable costs plus a certain percentage of fixed costs. A pipeline risks underrecovery of fixed costs "if it fails to achieve the sales volume used to calculate its rates." *Id.* For more information about pipeline ratemaking, see Wisconsin Gas Co. v. FERC, 770 F.2d 1144, 1149-52 (D.C. Cir. 1985); A. TUSSING & C. BARLOW, THE NATURAL GAS INDUSTRY (1984); Note, *Elimination of Variable Costs From Gas Minimum Bills:* Wisconsin Gas Co. v. FERC, 7 ENERGY L.J. 131 (1986).

15. 18 C.F.R. § 154.38(d)(4) (1986). Under a full-scale section 4 review, the Commission scrutinizes a pipeline's rates to ascertain whether they meet the just and reasonable standards mandated by the NGA. On the other hand, under the PGA alternative, pipelines will estimate their purchase costs for a six month period and, if accepted by the Commission, will collect them from their ratepayers. After the six months have elapsed, the actual gas costs are compared to the estimated costs. If the actual costs exceed the estimated costs, the difference is made up through a surcharge. If the estimated costs are greater than the actual costs, a refund is in order. Brief for Respondent, *see supra* note 10, at 4 n.7. *See* 18 C.F.R. § 154.38(d)(4)(iv)(d) (1986).

16. Id. § 154.38 (d)(4)(vi)(a) (1986).

gress partially deregulated many categories of gas.[17] A ceiling which eliminated the Commission's ratemaking authority was placed on wellhead prices for first sales of natural gas.[18] Section 107, or "high-cost", gas was exempted from all federal regulation.[19]

Because the deregulation only applied to producers, and interstate pipelines were still subject to FERC regulation, Congress excepted gas acquisition costs from pipeline regulation.[20] Section 601 of the NGPA coordinates the NGPA with the NGA by specifying the effects of the NGPA on specific provisions in the NGA, which still regulates pipelines.[21] If a category of gas is deregulated or if the price does not exceed its ceiling, any amount paid in a first sale is deemed just and reasonable.[22] Having declared the price to be just and reasonable, the Commission may not deny passthrough of the gas acquisition costs to the pipeline's customers "except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds."[23] This exception to the guaranteed passthrough of gas acquisition costs was at issue in *Consumers' Counsel*.[24]

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17. *Consumers' Counsel*, 783 F.2d at 213.

18. *Id.* First sales include sales to pipelines by independent producers and the pipeline's own production. *Id.* at 213 n.7; 15 U.S.C. § 3431(a)(1) (1982).

19. 15 U.S.C. § 3431(a)(1)(B)(i) (1982). Section 107 gas includes gas produced from wells that are completed below 15,000 feet, gas produced from geopressured brine, occluded gas from coal seams, gas produced from Devonian shale, and gas "produced under such other conditions as the Commission determines to present extraordinary risks or costs." 15 U.S.C. § 3317(c)(5) (1982). The Commission determined that section 107 gas includes the first sale of natural gas produced from tight formations and qualified production enhancement gas. 18 C.F.R. § 271.701 (1986). A tight formation is a sedimentary layer of rock cemented together in a way that hinders the flow of gas through the rock. Production enhancement gas is gas recovered as a result of secondary and tertiary recovery techniques. H. WILLIAMS & C. MEYERS, MANUAL OF OIL AND GAS TERMS 908 (6th ed. 1984).

20. 15 U.S.C. § 3431 (1982). "[T]he provisions of the Natural Gas Act and the jurisdiction of the Commission under such act shall not apply" to first sales of natural gas which were not committed or dedicated. *Id.* § 3431(a)(1)(A). The provisions also do not apply for first sales of committed or dedicated gas if it is high-cost natural gas, new natural gas, or if it is produced from any new, onshore production well. *Id.* § 3431(a)(1)(B). Any amount paid (acquisition costs) in any first sale is just and reasonable if it does not exceed its ceiling or if it has been deregulated. *Id.* § 3431(b)(1)(A).

21. 15 U.S.C. § 3431 (1982). Section 3431(a) of the NGPA coordinates with section 1(b) of the NGA (15 U.S.C. § 717(b)) and section 3431(b) of the NGPA coordinates with sections 4 and 5 of the NGA (15 U.S.C. §§ 717c-717d). Section 3431(c)(1) of the NGPA is an exception to section 7 of the NGA (15 U.S.C. § 717(f)) and section 3431(c)(2) of the NGPA is an exception to sections 4 and 5 of the NGA (15 U.S.C. §§ 717c-717d).

22. *Id.* § 3431(b).

23. *Id.* § 3431(c)(2).

24. *Consumers' Counsel*, 783 F.2d 206 (D.C. Cir. 1986)

B. *Facts: The Definition of Fraud, Abuse, or Similar Grounds*

After the passage of the NGPA in 1978, Columbia Gas Transmission Corporation (Columbia) began purchasing deregulated section 107 gas. Although the average cost of gas from all of its sources was $2.93 per Mcf during one six-month period in 1981-82,[25] Columbia entered into some contracts for 107 gas, at prices over $8.00 per Mcf.[26] Columbia attempted to pass through the added costs to its customers by filing for two PGAs.[27] Several protestors challenged the filings, alleging abuse in the section 107 purchases.[28] The Commission held a hearing to determine the truth of those allegations.[29]

Prior to the hearing, the Commission stated that the word "abuse" in the "fraud, abuse, or similar grounds" language "does not refer to imprudence but to serious improprieties."[30] The Commission stressed that the "protestants have a heavy burden of proof to demonstrate the impropriety that would trigger the 'fraud, abuse, or similar grounds' basis for denying passthrough of costs."[31] The Commission later reaffirmed that imprudent practices by the pipeline in acquiring gas, the NGA standard for finding gas acquisition costs to be unjust and unreasonable, do "not of [themselves] constitute abuse under section 601(c) of the NGPA."[32] To alleviate confusion and give Columbia and the interven-

25. Columbia Gas Transm. Corp., Initial Decision, 22 F.E.R.C. ¶ 63,093, at 65,320, 65,361 n.16 (1982) [hereinater *Initial Decision*]. The decision was published earlier, but information which was subject to a protective order was omitted from the first publication. 21 F.E.R.C. ¶ 63,100 (1982). The protective order was subsequently lifted on February 8, 1983. 22 F.E.R.C. ¶ 61,137.

26. *Opinion No. 204*, 26 F.E.R.C. at 61,097. Columbia argued that it needed this gas to ensure a steady supply plus a reasonable surplus, a surplus being necessary to combat potential shortages that past experience had shown may occur. *Id.* at 61,117. Columbia relied on its ability as a pipeline to "roll in" (average) the high-cost gas with its cushion of low-cost gas. "Rolled-in pricing, with only a few exceptions, has been Commission policy for quite some time." *Initial Decision*, 22 F.E.R.C. at 65,334; *see supra* note 10.

27. Columbia Gas Transm. Corp., 14 F.E.R.C. ¶ 61,202 (1981); Columbia Gas Transm. Corp., 16 F.E.R.C. ¶ 61,160 (1981).

28. *See infra* note 58. The protestors argued that the price Columbia paid for section 107 gas would exceed the market clearing price, except for Columbia's ability to roll in those costs with its lower priced gas. Although the record supported this argument, Columbia's ability to roll in brought its gas acquisition costs below the market clearing price. Therefore, "the merits of rolled-in pricing [were] not for determination." *Initial Decision*, 22 F.E.R.C. at 65,334; *see supra* notes 10 & 26.

29. Columbia Gas Transm. Corp., 14 F.E.R.C. at 61,380. Among the allegations made by the protestors was that Columbia made excessive purchases of section 107 gas, resulting in an excessive surplus on its system. 26 F.E.R.C. ¶ 61,034 at 61,116 (1984).

30. Columbia Gas Transm. Corp., 14 F.E.R.C. at 61,380. *See infra* note 33 and accompanying text.

31. *Id.*

32. Columbia Gas Transm. Corp., 15 F.E.R.C. ¶ 61,104 at 61,227 (1981). The Commission made it clear that the NGA imprudence standard and the NGPA abuse standard are not the same.

ors a tentative standard on which to formulate strategy for litigation, the FERC issued a non-binding statement of policy in February 1982.[33] In this statement the Commission defined the elements of section 601(c) by reference to tort law,[34] and stated that "abuse" is a "negligent misrepresentation or concealment," "fraud" is "fraudulent misrepresentation or concealment," and defined "similar grounds" as "inncocent misrepresentation of fact."[35]

In a hearing before an administrative law judge (ALJ) in February and March of 1982, the ALJ reformed the definiton of "fraud, abuse or similar grounds." The hearing addressed allegations that Columbia was guilty of abuse in passing through the costs of its section 107 gas.[36] The ALJ agreed with the Commission's earlier analysis that mere imprudence is an insufficient reason for the FERC to deny passthrough of gas costs, but he found the definition of abuse contained in the policy statement to be too narrow. The ALJ determined that Congress intended abuse to be something other than fraud and, because misrepresentation is an element of fraud, it was improper to define abuse as requiring misrepresentation.[37] While abuse may encompass misrepresentation, other inappropriate activities may fall under its meaning as well. The ALJ found that abuse fell somewhere between imprudence and fraud but did not give a precise definition.[38]

Looking at the alleged abuses in light of Congressional intent in enacting the NGPA, the ALJ considered the intent behind section 601(c).[39]

To some extent therefore, the NGPA § 601(c) standard abrogates the NGA standard. However, some NGA sections 4 and 5 violations remain intact. *See Consumers' Counsel*, 783 F.2d at 224. In addition, § 601(c) of the NGPA specifically incorporates NGA sections 4 and 5 by making deregulated gas and gas that does not exceed its ceiling price "just and reasonable" by definition. *See supra* notes 2 & 21 and accompanying text.

33. F.E.R.C. Stats. & Regs., REGULATIONS PREAMBLES, 1982-85, ¶ 30,336 at 30,103 (1982).

34. *Id.* at 30,110-15. The Commission found a lack of clear legislative guidance as to the meaning of the fraud standard. Similarly, common law principles fail to disclose a consistent definition. Fraud is a "term so vague that it requires definition in nearly every case." *Id.* at 30,110 (citing W. PROSSER, HANDBOOK OF THE LAW OF TORTS 684 (4th ed. 1971)). The Commission reviewed various sources of law and found *misrepresentation* to be the common thread in the various definitions. Elements of intent and scienter were also common. *Id.* at 30,110-13. "Abuse" was also difficult to define. "Disregard of a duty" was a common element, but whether it must be intentional was not clear. Because intent was required for "fraud," the Commission eliminated it from "abuse" so that negligent misrepresentations would be covered by the latter. *Id.* at 30,113. Because Congress intended that "similar grounds" would cover similar conduct that might escape the terms "fraud" and "abuse," the Commission felt it was reasonable that innocent misrepresentations would be encompassed in this element. *Id.*

35. *Id.*

36. *Initial Decision*, 22 F.E.R.C. at 65,322-23.

37. *Id.* at 65,332-33.

38. *Id.* at 65,333.

39. *Id.* at 65,346.

In so doing the ALJ determined that Columbia had been cutting back purchases of low-cost regulated gas while continuing to take high-cost gas above the take-or-pay level.[40] This practice increased purchase gas costs, which Columbia attempted to pass through to its customers during the PGA periods under consideration.[41]

The ALJ determined that, although "Congress was concerned with precluding any indirect regulation of excessive deregulated gas prices resulting from imprudent purchases," Columbia's activities were "unrelated to the payment of a particular price for deregulated gas as a result of imprudence. . . ."[42] The impropriety of Columbia's practice of cutting back on low-cost gas was at issue and, according to the ALJ, Congress does not guarantee passthrough under these circumstances. The NGPA provided for partial and phased deregulation of natural gas. However, allowing pipelines to cut back on purchases of low-cost regulated gas in favor of higher cost section 107 and other types of partially deregulated gas could effectively remove price-regulated gas from the market. These practices would contravene the Congressional intent to continue the sale of price-regulated gas.[43] Columbia's cutbacks were found to be serious violations of its fundamental obligation to provide gas at the lowest reasonable price and to have resulted in "excessive" payments for gas purchases.[44] The ALJ held the practices to be "abuse" under section 601(c)(2) of the NGPA and, thus, denied passthrough of the excessive costs that resulted from the abuse.[45] No other conduct by Columbia was found to constitute abuse under the NGPA.[46]

In January of 1984, the Commission reviewed the ALJ's decision in *Opinion No. 204,* affirming in part and reversing in part.[47] The Commission, like the ALJ, rejected the definition of "abuse" which appeared in its earlier policy statement[48] and articulated a new two-part test. It expanded abuse to include: (1) "circumstances where a pipeline's gas ac-

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40. *Id.* at 65,345. Among the reasons Columbia offered in defense of its cutback practices were that producers generally have the contractual right to make operational decisions for the production of a lease or field, Columbia may be required to purchase higher-priced volumes above take-or-pay levels to satisfy delivery obligations to third parties, and some higher-priced gas is used to directly serve Columbia's customers, and this gas cannot be shut in or these customers would be curtailed.

41. *Id.*

42. *Id.* at 65,346.

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 65,333-53.

47. 26 F.E.R.C. ¶ 61,034 (1984).

48. *See* F.E.R.C. Stats. & Regs., REGULATIONS PREAMBLES ¶ 30,336 (1982); *see also supra* notes 33 & 34 and accompanying text.

quisition policies and practices evidence a *reckless disregard* of the pipeline's fundamental duty to provide service at the lowest reasonable cost, *and* (2) such policies have *significant, adverse consequences*" on customers or consumers.[49] The "reckless disregard" standard was viewed as "an aggravated form of negligence, differing in quality rather than in degree from ordinary lack of care or imprudence, but does not require a showing of intent to cause harm."[50] The second prong of the test, that the "policies have significant, adverse consequences," is satisfied if there is a "significant, adverse effect on customers (such as a significant loss of market) or consumers."[51] The Commission found that Columbia's cutback practices did not have a "significant, adverse effect on customers or consumers" and reversed the ALJ's finding that the practices were abusive.[52]

The Commission formulated this test in light of pipeline regulation tenets[53] and its interpretation of the NGPA.[54] Historically, pipeline rates have been set so that ratepayers pay "only necessary and reasonable costs of service"[55] and so that the pipeline can earn a just and reasonable return under "efficient and economical management."[56] The guaranteed passthrough right in section 601(c)(2) includes a duty of the pipeline to take reasonable measures to minimize costs.[57]

In *Opinion No. 204-A*, a rehearing that largely affirmed *Opinion No. 204*, the Commission defended its reading of the NGPA against arguments from various parties,[58] some arguing that the definition of "abuse"

49. *Opinion No. 204*, 26 F.E.R.C. at 61,100 (emphasis added). The initial policy statement defined abuse as "misrepresentation," an element of fraud. However, "abuse" may include inappropriate activities, in addition to misrepresentation. 22 F.E.R.C. at 65,333. *See supra* note 35.

50. *Opinion No. 204*, 26 F.E.R.C. at 61,100.

51. *Id.*

52. *Opinion No. 204*, 26 F.E.R.C. at 61,103. The Commission's review was limited to the March 1981-February 1982 period at issue. "[W]e are concerned that these practices carry significant potential for causing market loss in the future." *Id.*

53. *Opinion No. 204*, 26 F.E.R.C. at 61,100. "It is a long-standing tenet of pipeline regulation that a pipeline must provide service in an efficient manner." *Id.*

54. *Id.*

55. *Id.* (quoting Midwestern Gas Transm. Co., 36 F.P.C. 61, 70-71 (1966), *aff'd*, 388 F.2d 444 (7th Cir.), *cert. denied*, 392 U.S. 928 (1968)).

56. *Id.* (quoting Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 693 (1923)).

57. *Id.*

58. The parties were Exxon Corp., Public Utilities Commission of Ohio, Public Service Commission of New York, Associated Gas Distributors, Baltimore Gas & Electric Co., Office of Consumer Advocate of Pennsylvania, Washington Gas Light Co., Columbia Gas Transmission Corp., Cities of Charlottesville and Richmond, Virginia, Process Gas Consumers Group, Interstate Natural Gas Association of America, UGI Corp., Office of Consumers' Counsel, Energy Action Project of the Citizen/Labor Energy Coalition, and Senator Howard Metzenbaum. *Id.* at 61,334.

was too narrow, and others arguing that it was too broad.[59] With regard to the first part of its test, the Commission determined that "abuse" is not equivalent to "imprudence" (the NGA standard) because Congress intended the NGPA to guarantee passthrough of gas costs, subject only to certain exceptions.[60] If imprudence were one of those exceptions there would have been no point in passing section 601(c)(2) because the criteria for denial of passthrough would be the same as the original criteria found in sections 4 and 5 of the NGA. Further, it would be illogical for Congress to intend for imprudence to be an exception to the guarantee and "revert back to precisely the same standard for the Commission review of gas costs . . . as existed under the NGA."[61] The Commission concluded that Congress intended to provide it with "enforcement authority that is narrower than the general review authority provided under the NGA."[62]

The second part of the test, requiring that the reckless conduct must have a significant, adverse effect on customers and consumers, came under attack by the protestants as being too narrow. Some parties argued that while, in tort law, disregard of a duty coupled with a loss or damage to the innocent party can justify an award of punitive *damages,* the effect of a pipeline's conduct should be irrelevant in determining *abuse* under section 601(c)(2).[63] The Commission dismissed this assertion by stating that this case is not an action in tort.[64] Because Congress intended section 601(c)(2) to limit FERC regulation of certain types of gas to "exceptional circumstances," conduct by a pipeline "must have more than an insignificant effect on the public to be abusive."[65]

Opinion 204-A explained the application of the two-part abuse standard of section 601(c)(2) to determine what gas costs may be denied. Passthrough of gas costs may not be denied unless "the amount paid was

59. Columbia Gas Transmission Corp., 26 F.E.R.C. ¶ 61,334 (1984) [hereinafter *Opinion No. 204-A*].

60. *Id.* at 61,710.

61. *Id.*

62. *Id.* at 61,711.

63. *Id.* at 61,712.

64. *Id.* This appears to be self-contradictory. The Commission itself defined "fraud, abuse, or similar grounds" by reference to tort law. *See supra* notes 34 & 35 and accompanying text. When the original "abuse" standard (misrepresentation) was abandoned in favor of the "reckless disregard of its duty" prong of the new test, the Commission used tort law to explain the parameters of the new test. It stated that between intent to do harm, and the mere unreasonable risk of harm involved in ordinary negligence, there is "quasi intent" which includes "willful," "wanton," and "reckless." *Opinion No. 204-A*, 26 F.E.R.C. at 61,712 (citing W. PROSSER, HANDBOOK OF THE LAW OF TORTS 184 (4th ed. 1971)).

65. 26 F.E.R.C. at 61, 711-13.

excessive due to fraud, abuse, or similar grounds."[66] The abuse must cause "excessive" payments and only those excessive payments may be denied. The determination of when the amount paid becomes "excessive" is the critical factor.[67]

III. *CONSUMERS' COUNSEL V. FERC*

The court in *Consumers' Counsel* began its inquiry into the FERC's interpretation of "abuse" by ascertaining "whether Congress has directly spoken to the precise question at issue."[68] If the intent of Congress is clear, both courts and agencies must adhere to that intent. If Congress has not directly addressed the issue, the court may not impose its own construction of the statute but must determine if the agency's construction is "within the permissable [sic] *range* of interpretations."[69] The agency's construction need not be the only permissible one nor even be the one the court would have chosen had it decided the question initially.[70]

The *Consumers' Counsel* court looked at the NGA and NGPA as a whole, and specifically focused on section 601(c).[71] It noted that section 601(c) guarantees passthrough of gas acquisition costs that are just and reasonable. Section 601(b) states that any amount paid is just and reasonable if the gas is deregulated or if it has not exceeded its ceiling price.[72] The court then examined the exception to this guaranteed passthrough: payments that are "excessive due to fraud, abuse, or similar grounds."[73] Proposed definitions for abuse can be placed into two categories: those which categorize abuse as a form of misrepresentation, and

66. 15 U.S.C. § 3431(c) (1982).

67. 26 F.E.R.C. at 61,713. The Commission's interpretation is in line with the court's view of § 601(c) that excessive payments must result from "fraud, abuse, or similar grounds" for passthrough to be denied. The Commission, however, felt that the conduct must be serious to cause a denial of passthrough. "In light of the seriousness of the conduct which must cause an increase in gas costs before the increased costs can be denied passthrough, we believe that all amounts paid that are attributable to abuse are excessive." *Id.* The Commission's measure of serious conduct appears to require significant, adverse effect on customers or consumers. The court's measure is the mere existence of an excessive payment due to fraud, abuse, or similar grounds. *See also infra* notes 90 & 91 and accompanying text.

68. *Consumers' Counsel*, 783 F.2d at 218 (citing Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984)).

69. *Id.*

70. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 n.11 (1984).

71. *Consumers' Counsel*, 783 F.2d at 211, 218-23.

72. *Id.* at 219.

73. 15 U.S.C. § 3431(c)(2)(B) (1982).

those which equate abuse with imprudence.[74]

Columbia argued that abuse should be defined as it was in the FERC's initial policy statement. This assertion was rejected for the same reason the FERC rejected it. If in the form of misrepresentation, abuse is effectively read out of the statute because misrepresentation is an element of fraud. In addition, "fraud or similar grounds" "would cover the same spectrum of activities as would the interpretation . . . urged by Columbia."[75]

The court also rejected arguments that the Commission should equate "abuse" with the "imprudence" or the "unjust and unreasonable" standard of the NGA. Section 601(c) establishes a different standard, on its face, through the "fraud, abuse, or similar grounds" language. If the two standards were equated, there would be no reason for the section 601(c) exception because inquiries could be conducted pursuant to the NGA.[76] Furthermore, section 601(b) *defines* the cost of certain categories of gas as "just and reasonable" and Congress did not intend for the FERC to determine whether the cost of these categories of gas were just and reasonable.[77]

The court found that the meager legislative history on section 601(c) supports the position that "abuse" falls somewhere between misrepresentation and imprudence. Although the "fraud, abuse, or similar grounds" language was not in either version of the House or Senate bills, both bills were attempting to limit the FERC's regulation of wellhead prices with the passage of the NGPA. Thus, the "imprudence" standard could not have been intended.[78] The first mention of fraud and abuse was in a staff report to the conference committee on the NGPA, which stated that there was to be no indirect or "back door" regulation by the FERC but there was also "no intention to override the inherent enforcement power of the FERC to police fraud, abuse, etc."[79] If the Commission could easily deny passthrough of the prices paid to producers, it could indi-

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74. *Consumers' Counsel*, 783 F.2d at 219-20.
75. *Id.* at 219 (citing *Opinion 204-A*, 26 F.E.R.C. at 61,710).
76. *Id.* at 220.
77. *Id.*
78. *Id.* Section 5(a) of S. 2104, which was also part of H.R. 5289, stated that "the Commission shall have no power (1) to deny, in whole or in part, any rate or charge made . . . except (A) to the extent that such rates or charges . . . exceed the national ceiling or interim ceiling. . . ." 123 CONG. REC. 32,306 (1977).
79. *Consumers' Counsel*, 783 F.2d at 220 (citing STAFF OF HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE AND SENATE COMM. ON ENERGY AND NATURAL RESOURCES, 95TH CONG., 2D SESS., NATURAL GAS PRICING AGREEMENT ADOPTED BY THE CONFEREES ON H.R. 5289, at 19 (Comm. Print 1978)).

rectly regulate the prices producers charged.[80]

Arguments that the staff report did not reflect congressional intent because it was written before the fraud and abuse language was added to the statute were dismissed with the court stating that "it does reflect a congressional concern with regulation of wellhead prices which is *consistent* with FERC's interpretation of the statute."[81] Even if the staff report did not reflect congressional intent, no party produced legislative history that was inconsistent with the Commission's position.[82]

After stating that "abuse" falls somewhere between misrepresentation and imprudence, and finding that Congress has not "unambiguously expressed [its] intent" on the definition of abuse, the court concluded that "reckless disregard" falls within the permissible range of interpretations.[83] The court noted that the Commission's reference to tort law was not the best way to define "abuse" but did not find it inconsistent with congressional intent,[84] and further noted that in settling upon the proper standard there are two competing policies to be accommodated: first, the congressional concern with "back door" regulation and, second, the longstanding tenet of pipeline regulation that pipelines must operate efficiently. The court found that the "reckless disregard" standard accommodates both policies.[85]

Although the first prong of the FERC's test was permissible, the

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80. *Consumers' Counsel*, 783 F.2d at 221.
81. *Id.* at 220 (emphasis in original).
82. *Id.*
83. *Id.* at 220-21.
84. *Id.* at 221. The Commissioner's reasons for turning to tort law for guidance in determining the proper standard for abuse may be explained more fully in reference to a statement made in June, 1984, by Commissioner Hughes. Statement of Commissioner Hughes to Opinion No. 204-A, 27 F.E.R.C. ¶ 61,475 (1984) [hereinafter Commissioner's Statement]. In answer to arguments that tort law is inapplicable where an action under a federal statute is involved, Commissioner Hughes examined several federal regulatory schemes and determined that securities regulation (specifically the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1982)), is analogous to the regulatory scheme presented in the NGA and the NGPA. "In securities cases, courts have recognized that an action to recover damages for violation of a federal statute or administrative regulation may be regarded as a common law action in tort." Commissioner's Statement, 27 F.E.R.C. at 61,904-05 (citing Goldman v. Bank of Commonwealth, 467 F.2d 439, 446 (6th Cir. 1972); Junger v. Hertz, Newmark & Warner, 426 F.2d 805, 806 (1970), *cert. denied*, 400 U.S. 880 (1970); 79 C.J.S. *Securities Regulation* § 129 at 367, 369 Supp. (1982)). Therefore, because securities regulation is analogous to natural gas regulation, Hughes reasoned that tort concepts are applicable to the statute at hand. Commissioner's Statement, 27 F.E.R.C. at 61,905. The *Consumers' Counsel* court made it clear that, whatever the reason for turning to tort concepts for guidance, the Commission was well within its rights in adopting a tort standard. "While . . . the Commission *may* turn to other statutes . . . for guidance in its interpretation of 'abuse,' . . . the agency is not *compelled* to do so." *Consumers' Counsel*, 783 F.2d at 221 n. 31 (citing 2A N. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 53.03 (rev. 4th ed. 1984)) (emphasis in original).
85. *Consumers' Counsel*, 783 F.2d at 221.

court found the requirement that it have "significant, adverse consequences" on customers or consumers was "inconsistent with the plain meaning of section 601(c)(2)."[86] The FERC was correct that reckless conduct alone does not justify a denial of passthrough.[87] However, section 601(c)(2) states what effect the reckless conduct must have. Recovery of gas acquisition costs may be denied "to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds."[88] The *effect* required for denial of passthrough is an *excessive payment.*[89] "Requiring *abuse* to encompass a significant adverse effect — *i.e.*, over and above excessive payments — is flatly inconsistent with Congress' clear message on this precise issue, and therefore impermissible."[90]

The FERC argued that "significant, adverse effect" equalled "excessive payments," but the court held that the two standards are not the same. The Commission had misguidedly looked to significant market loss rather than excessive payments as its requirement for denying passthrough.[91] The court concluded that an inspection for excessive pay-

86. *Id.* at 222; *see also supra* note 67.

87. *Id.*

88. 15 U.S.C. § 3431(c)(2) (1982).

89. *Consumers' Counsel,* 783 F.2d at 222. The court stated, "*Any* excessive payment for gas has a direct effect on customers and consumers because it is normally passed through . . . ." *Id.* at 222 n.33 (emphasis in original).

90. *Consumers' Counsel,* 783 F.2d at 222. The Commission's interpretation departed from the court's interpretation when it found that the exception only applies in exceptional circumstances. It then concluded that, to be an exceptional circumstance, the "conduct must have *more than an insignificant effect* on the public to be found abusive." *Opinion 204-A,* 26 F.E.R.C. at 61,712-13 (emphasis added). Commissioner Hughes argued that while the Commission's significant effect standard was incorrect, there should nevertheless be *some* harm to the aggrieved party before abuse is found. Hughes turned to the Natural Gas Act, 15 U.S.C §§ 717-717w (1982), and the Federal Power Act, 16 U.S.C. §§ 791-798 (1982) (FPA), stating that these Acts "do not prescribe criteria any more explicit than that rates charged must be just and reasonable. The Acts are silent as to whether injury to the complaining party must be shown." Commissioner's Statement, *supra* note 84, at 61,903. The Commissioner then cited Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246 (1951), in which the court dismissed a complaint under the FPA alleging that the rates paid were excessive and that constructive fraud had been perpetrated by Northwestern. The Court dismissed the complaint on the grounds that *no harm* had been shown as a consequence of the unreasonable rates. Commissioner's Statement, *supra* note 84, at 61,903 (citing *Montana-Dakota Util. Co.,* 341 U.S. at 254). After reviewing several other regulatory schemes, Hughes concluded that "[i]n areas where explicit standards of conduct have not been prescribed by statute or by regulation, a complaining party has been required to demonstrate that harm has been suffered. The latter situation is illustrated . . . by public utilities regulation where the imprecise statutory standards prescribe just and reasonable rates." Commissioner's Statement, *supra* note 84, at 61,903-04.

91. *Consumers' Counsel,* 783 F.2d at 223. It may be argued that the only difference between the court's test and the FERC's is that the FERC looked for a significant market loss to determine if the price was excessive. "We examined the adverse effects that the parties claimed were the result of Columbia's conduct, including load loss and increased gas costs." The Commission went on to look at all of Columbia's practices to determine if it suffered a significant market loss. *Opinion 204-A,* 26

ments is always required when an exception to guaranteed passthrough is sought.[92]

IV. CONCLUSION

The *Consumers' Counsel* court held that "abuse" means "reckless disregard of [the pipeline's] duty" to provide gas at the lowest reasonable price and that the price paid was "excessive" because of the reckless conduct. Under section 601(c) of the NGPA, denial of passthrough may only be made if both parts of the test are met.[93]

The court stated that its role as a reviewing court was not "to dictate the *particular* test that the Commission should use to deny passthrough."[94] It remanded to the FERC to further consider the standard for denial of passthrough in light of the court's interpretation.[95] At the time of this writing, it has been nearly a year since the court rendered its decision but the Commission has not yet released a new policy defining "abuse" under section 601.

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F.E.R.C. at 61,713-32. However, the Commission also stated, "[t]hus, only if and to the extent that abusive conduct actually causes the amount paid for gas to be 'excessive' is passthrough denied." *Opinion 204-A*, 26 F.E.R.C. at 61,713. If the FERC had determined "the extent that abusive conduct actually causes the amount paid for gas to be "excessive," rather than determining "significant market loss," the court may have found the FERC's interpretation to be permissible.

92. *Consumers' Counsel*, 783 F.2d at 222. The court specifically stated that "any test for the exception to guaranteed passthrough must involve an examination for excessive payments for natural gas. This requirement applies uniformly with respect to all cases of 'fraud,' 'abuse' and 'other similar grounds' under subsection 601(c)(2)." *Id.* at 222-23.

93. *Id.* at 212.

94. *Id.* at 223 (emphasis added).

95. *Id.* Although the court left it up to the Commission, there was language hinting that the Commission's determination should be the same as the court's interpretation. "[W]e think a reasonable reading of excessive payment is the difference between what the pipeline actually paid for the gas and the lower amount it would have paid absent the abusive or fraudulent conduct." *Id.*