LEXSEE 23 F.E.R.C. 61140

Off-System Sales

Docket No. PL83-2-000

FEDERAL ENERGY REGULATORY COMMISSION - Commission

23 F.E.R.C. P61,140; 1983 FERC LEXIS 2141

Statement of Policy

April 25, 1983

PANEL:
[**1] Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

OPINION:
[*61,305] The Federal Energy Regulatory Commission (Commission) annouces a general policy regarding off-system sales by interstate pipelines. The term "off-system sale" connotes a sale of natural gas that is excess to the pipeline's current demand, that is of a short-term, interruptible nature, and that is made to a customer outside or away from the pipeline's traditional or historic market area.The purpose of this policy statement is to provide guidance for the efficient disposition of pending or future cases which propose off-system sales. The Commission is mindful that a general policy statement does not have the force and effect of law. Instead, it is an articulation of the Commission's tentative intention, which will be followed unless particular circumstances demonstrate the policy to be inappropriate. In individual cases, both the underlying validity of the policy and its application to particular facts may be challenged and are subject to further consideration.I. BackgroundThis policy statement is intended to deal with the major issues identified in the November [**2] conference n1 and related comments that are common to all the off-system sale proposals. It is not exhaustive, which is to say that for a particular proposal there may be issues or concerns influencing the Commission's decision that are not discussed in this policy statement. As a general matter, however, the Commission expects that applications for off-system sales that are consistent with this policy statement will be processed on an expedited basis.

n1 Convened in Docket No. GP82-47, "Review of Off-System Sales Program," pursuant to a notice issued August 6, 1982.

When the Commission first began authorizing the current round of off-system sales (in late 1980), such sales served the purpose of allowing pipelines and distributors that were short of gas supplies to purchase gas from pipelines that had a surplus.In the summer of 1981 the Commission again considered offsystem sales, but with a somewhat different emphasis. The gas surplus was becoming more prevalent, and some pipelines began to project significant levels of prepayments for gas not taken. Off-system sales were thought to be a way of ameliorating the take-or-pay problem while at the same time permitting pipelines [**3] to continue to contract for long-term reserves, even though they did not need the short-term deliverability increases that accompanied such contracts. From the buyer's standpoint, offsystem sales served not only to ease physical shortages, but also gave the buyer access to less expensive gas. [*61,306] During the past two years, the Commission has authorized offsystem sales involving approximately 1 Tcf of gas. Something less than 240 Bcf has actually been sold. Despite the relatively small portion of authorized volumes sold, off-system sales have had a significant impact in the States of California and Louisiana. However, no off-system gas has been sold in California since August 1982, and more recently, only two pipelines—Northern Natural Gas Company and Natural Gas Pipeline Company of America—could be described as making substantial off-system sales. Both pipelines have relatively low 100% load factor rates enabling them to find markets off their systems, primarily in Louisiana.Now virtually all interstate pipelines have a supply surplus. For 1982, there existed something over 2 Tcf of excess annual deliverability. According to American Gas Association estimates, it appears that the comparable [**4] number for 1983 will be closer to 3 Tcf. The surplus is still short-term, but nonetheless it is a present reality.There has been one other change over the past two years, not unrelated to the gas surplus, and that is the dramatic shift in the relative prices of gas and oil. In 1980, oil prices were well above gas prices. Today, gas prices are equal to or exceed the cost of high sulfur No. 6 fuel oil at many places in the

country.Although off-system sales have not been as successful as the selling pipelines had projected, some gas has been sold through off-system sales that otherwise would not have been, take-or-pay levels have been reduced to some degree, some fuel oil has been displaced, and buyers were able to purchase gas at prices lower than they otherwise would have to pay.Not everyone has been in favor of off-system sales. As the Commission heard at the November 1982 conference (and as it has read in the adverse interventions filed in particular dockets), a number of traditional customers of selling pipelines have opposed the sales. They have objected because they consider the sales prices to be too low and not available to on-system customers on the same basis, because the [**5] pipeline should be husbanding its gas supplies instead of selling off-system, because the pipelines are buying high cost gas to replace the lower cost gas that is being sold off-system, and because they see off-system sales as relieving the pressure to make more fundamental changes in gas purchasing practices and gas supply contracts.Certain intrastate pipelines (and the producers who sell to them) have also opposed off-system sales. They claim to be facing the same marketing problems as the interstate pipelines—softening demand, excess deliverability, take-or-pay exposure, shut-in wells, and competition from oil—and object to interstate pipelines with regulated gas cushions being able to undercut their prices in the intrastates' traditional markets. In effect, they claim that off-system sales will simply shift the problems of the interstate pipelines to the intrastate market.Some commenters urged that off-system sales be prohibited, others urged that opportunities for off-system sales be opened up to increase the volumes of gas that might be sold. Our review of the transcript of the November conference and the comments that were filed in connection with the conference convince [**6] us that offsystem sales do have a role to play in the current circumstances of the natural gas markets, although that role may be more limited than some would hope.II. ObjectivesIn our view, an appropriate off-system sales policy should serve the following objectives:(1) Permit pipelines with excess gas supplies to sell to pipelines (interstate, Hinshaw, or intrastate) and local distribution companies experiencing a physical gas shortage.(2) Permit pipelines with excess gas to sell to pipelines, local distribution companies, and end-users who would otherwise purchase more expensive gas.(3) Ameliorate take-or-pay problems.(4) Accomplish the first three objectives without unduly burdening the selling pipeline's traditional customers and without simply transferring problems of the interstate pipelines to the intrastate market.

This last objective will require the Commission to give careful scrutiny to certain kinds of transactions. Data have been presented to the Commission demonstrating that the problems of excess supplies, mounting take-or-pay obligations, and competition from alternative fuels that have compelled interstate pipelines to seek off-system sales are also plaguing [**7] the intrastate market. Certain intrastate pipelines claim that off-system sales by interstate pipelines have caused and will cause the intrastate pipelines to lose portions of their market to the interstate pipelines. The intrastate pipelines claim that such market loss is made possible solely because of the cushion of price-regulated interstate gas n2 that is not available to the intrastate market. It is not immediately obvious that market loss of this sort is appropriate or desirable. It appears only to solve a problem in the interstate [*61,307] market by creating or exacerbating a problem in the intrastate market. Accordingly, where an interstate pipeline proposes an off-system sale that would cause a direct loss of market by an established supplier, our review of the public convenience and necessity will include an examination of the market impact of the proposed transaction on existing suppliers of the intended buyer. n3

n2 See Sections 104 and 106(a) of the Natural Gas Policy Act.

n3 Such an inquiry might also be appropriate where established suppliers other than intrastate pipelines raise the objection.

III. CriteriaThe issue of price drew the most attention in the comments [**8] and at the conference. We conclude that where the proposed sale is between two interstate pipelines, the transaction should be priced at the higher of the selling pipeline's system average load factor rate (based upon the rates in effect at the time the transaction is proposed) or its average Section 102 gas acquisition cost (based upon its most recent purchased gas adjustment filing). Where the purchaser is not another interstate pipeline, the selling pipeline would be free to negotiate a higher rate.Such a rate would ensure, as a general matter, that the sales off-system would not be made at a price lower than is available to on-system customers. Thus the rate can be said to be non-discriminatory. The off-system sale price should also be compensatory. The compensatory requirement would ensure that on-system customers would be no worse off than if the sale had not been made. In choosing this rate methodology, it is our assumption that the pipeline could replace any gas it sold off-system through additional purchases of Section 102 gas.We have previously stated that allegations of market loss by an established supplier of the buyer identified in a specific transaction raise serious [**9] questions that require case-specific analysis and close scrutiny. As one part of our examination into whether or under what circumstances such a transaction should be authorized, we intend to inquire into the relative competitive positions of the two suppliers and whether the interstate pipeline may be able to compete at the marginal cost of making the sale (while recovering its fixed costs

elsewhere) against an intrastate pipeline that would be recovering its fixed costs in the rates for the intrastate's traditional market area involved in the proposed sale. In such a case, it may be appropriate to require that the basic price discussed above be increased by an amount to reflect some portion of the interstate pipeline's fixed costs.An issue related to price is the treatment of revenues derived from the off-system sale. In the past we have generally required that revenues from off-system sales be credited to Account No. 191. In two instances, the pipelines have established representative volume levels for off-system sales in their general rate cases. We conclude that pipelines should have the option to choose either to credit revenues or to establish representative levels of off-system [**10] sales or revenues in their rates. Thus, a pipeline may establish representative volumes or revenues in its general rate proceeding and avoid the crediting of revenues in excess of costs. Alternatively, the pipeline would credit to Account No. 191 all revenues from off-system sales in excess of one cent per MMBtu (as representative of out-of-pocket costs). The pipeline could also demonstrate and retain an amount of actual out-of-pocket costs in excess of one cent per MMBtu.To be eligible to make an off-system sale, the selling pipeline must demonstrate a sufficient surplus that service to existing customers will not be impaired and must also demonstrate at least potential take-or-pay liability. The reason for the surplus requirement is obvious. The whole premise of off-system sales is that there is a surplus. If it appears that the pipeline's supplies are marginal, or will be so within a short space of time, the pipeline should not be selling off-system. The requirement that the pipeline show at least potential take-or-pay liability is based on the assumption that on-system customers incur a detriment when the sale is made, at least in the sense of having contracted reserves being [**11] sold away. The off-system sale may also have the effect of increasing their average cost of gas. The requirement that the pipeline demonstrate at least potential take-or-pay exposure would give some measure of an offsetting benefit in the form of avoided take-or-pay liability.In past cases, the Commission has inquired as to the potential buyer's need for the additional supplies. In some cases that need has been a physical one, in the sense that without the off-system purchase the buyer would have had to curtail deliveries to its customers. In other cases, the buyer has demonstrated a need for less expensive gas supplies by alleging either potential load loss if costs are not reduced or discriminatory prices on various parts of its system due to differences in the rates of its pipeline suppliers. Based on our review of the record, we believe that the buyer's need for the gas should not be an issue in the proceeding, beyond a demonstrated willingness on the part of the buyer to purchase (in the form of an executed contract). Requiring more introduces issues that do not appear to be central to the [*61,308] decisions we must make with respect to off-system sales.As a corollary, however, there [**12] must be specific identification of the buyer (either an end-user, or a pipeline or local distribution company with an established market). Specific identification of the buyer will enable the Commission to identify all of the factors relevant to making a determination as to the public convenience and necessity of the proposed sale. In particular, it will enable the Commission and interested parties to determine whether the proposed transaction presents the potential for market loss described above.The one exception to the requirement to identify the buyer specifically will be for transactions between two interstate pipelines. The notice of proposed rulemaking in Docket No. RM81-29 (Phase II of the blanket certificate rulemaking proceeding [*FERC Statutes & Regulations* P32,132]) included a provision authorizing off-system sales between two interstate pipelines. The Commission intends to adopt a final rule in Docket No. RM81-29 which will include a provision authorizing offsystem sale transactions between two interstate pipelines subject to the prior notice provisions adopted in Docket No. RM81-19 and included in the regulations as Sections 157.201, *et seq* . (18 C.F.R. [**13] §§ 157.201, *et seq* .), so long as the transaction is otherwise consistent with this policy statement. The authorizations applied for under the blanket certificate could be either for a specified transaction or for specified volumes within a one-year period to be sold to unspecified interstate pipelines. Applications for blanket certificate authority outside the parameters adopted in Docket No. RM81-29 will generally be denied.The Commission does not see a need to impose end-use restrictions on the off-system sales. This position is consistent with Commission policy expressed, for example, in Opinion No. 10-B [21 FERC P61,320], with respect to producer reservations. The principal market for off-system sales has been the boiler fuel market where fuel oil is the alternative to natural gas. We see no reason to place restrictions on the use of off-system sale gas, at least under present circumstances.As to curtailment status, the off-system sales previously authorized were made on a "best efforts" basis, with a requirement that the sale be interrupted prior to interruption of on-system customers. We believe that policy should be continued. The fundamental predicate for making [**14] off-system sales is that the gas is surplus to the requirements of the pipeline's historic market. *A fortiori* , that historic market has a service preference over transactions that are made possible only when and to the extent that a surplus exists. While questions may arise with respect to the relative priority to be accorded more than one off-system sale by the same pipeline, we express no view on that subject here. Where it develops as a genuine issue, we will pursue the matter on the basis of the record developed in a particular proceeding.In the past we have authorized off-system sales for a one-year term, without prejudice to the seller seeking to extend the sale. We will continue to limit off-system sales to a one-year period. The rapid changes in the nature of the gas markets that have occurred in the last year have convinced us, more than ever, that all participants in decisions

concerning future transactions need to remain flexible. We cannot now discern whether the considerations that lead us to authorize off-system sales now will continue to exist a year or more from now.IV. Procedural MattersA number of pipelines urged that we expedite the process of deciding [**15] cases concerning off-system sales. We believe that this policy statement should expedite case dispositions by serving to narrow the scope of the issues involved, and by providing guidelines for the industry and the Staff as to the nature of transactions the Commission is prepared to authorize on more or less a routine basis. Where applications propose off-system sales that are consistent with the policy statement, we expect such applications to be processed expeditiously.We are also taking two other steps. First, as stated above, we expect to include in the final rule issued in Docket No. RM8129 a provision authorizing off-system sales between interstate pipelines. Second, we will delegate to the Director of the Office of Pipeline and Producer Regulation the authority to issue a certificate of public convenience and necessity authorizing an off-system sale where the application is uncontested and consistent with the terms of this policy statement.Finally, with respect to cases where there is a specific allegation of market loss made by an established supplier of the potential buyer, we believe that an evidentiary hearing to explore the various issues discussed above with respect [**16] to market loss is likely to be the only way of developing a record sufficient for the Commission to decide whether the proposed transaction is required by the public convenience and necessity. In this connection, the pipeline or distributor raising the objection must allege with specificity, and be prepared to prove, that the potential buyer is a current [*61,309] customer on the objector's system and that the selling pipeline's sales advantage is due to the statutory framework of the Natural Gas Act and the NGPA, which subject the nation's gas supplies to disparate price ceilings.Chairman Butler *concurred* with a separate statement attached .Commissioner Sheldon *dissented* with a separate statement attached.Commissioner Richard *concurred* with a separate statement attached.

CONCURBY: BUTLER; RICHARD

CONCUR:

BUTLER, Chairman, concurring:"A fair field and no favor."This was a primary goal of many who sought to ensure fair competition in American industry in the early part of this century and it remains our goal today. But the natural gas industry has been largely shielded from competitive forces over the last three decades by federal wellhead price controls. These price controls have created [**17] market distortions and disorders which at one time advantaged the intrastate gas market to the disadvantage of the interstate market, but which now advantage the interstate market to the disadvantage of the intrastate one. Throughout this period, these controls have and continue to deprive the Nation's gas consumers of the benefits of free and fair competition.Today, with the inexorable escalation of price ceilings mandated by Congress, unfortunate contract provisions spawned in response to price controls, and the impact of high-priced imports, the average natural gas price has overshot competitive, market-clearing levels in many regions. Abruptly, the day of competition has arrived.In the absence of legislation to address current disorders, we at the Commission must tread a difficult path as we seek to protect and foster competition, but not competitors. Similarly, we should encourage competitive, but not predatory, pricing. These are the considerations which, in any judgment, require the Commission, as it does in the statement of policy, to examine the market impact of proposed transactions where it appears that the off-system sale will cause a direct loss of market by [**18] an established supplier.The "cushion" of low-priced gas under sections 104 and 106(a) of the NGPA is a direct result of statutory price controls which forbid sales of that gas at market-clearing prices. Meanwhile, section 105, controlling older supplies of previously intrastate gas, provides that the price under the contract as it existed on November 9, 1978, is itself the maximum lawful price for that gas (so long as it does not exceed the section 102 price). In this way the statute in general allowed existing intrastate contracts to operate as they had been drafted. n1 Prices for this gas, which were considerably higher than prices for interstate gas prior to enactment of the NGPA, thus remain at those higher levels.

n1 The operation of these contracts is limited, however, by the fact that prices above the § 102 level on the date of enactment were frozen at that level until the § 102 escalator reached that level, after which the contract price may increase with the § 102 escalator according to the contract terms. See NGPA § 105(b)(2) and Joint Explanatory Statement of the Committee on Conference, I Federal Energy Guidelines, FERC Statutes and Regulations P3101 at 3090-3091.

[**19] Accordingly, the gas supply "mix" of interstate pipelines as a whole is priced substantially below the levels prevailing among intrastate companies. Moreover, there is substantial variation in the weighted average cost of gas (or "WACOG") among the interstate companies. See Energy Information Administration, An Analysis of Post-NGPA Interstate Pipeline Wellhead Purchases, (Part III of An Analysis of the Natural Gas Policy Act and Several Alternatives) (DOE/EIA-0357) (September 1982) (at 14). It is plain from reviewing this study that, as a general rule, the average price

of the pipeline's domestic supply is directly linked to the relative amount of section 104 and 106(a) gas in the supply mix. The greater the percentage which old gas represents in the mix, the lower the average wellhead acquisition price. Id., compare table 3 with table 5. n2

n2 Of course, to the extent a pipeline needs to acquire additional supplies, bidding for relatively small volumes of high-cost domestic gas or imported gas can quickly raise the overall average cost of gas. While a "deep" cushion is necessary to maintain a low WACOG, it is not a guarantee.

Under these circumstances, the competitive advantage enjoyed today by "deep cushion" interstate pipelines is predominantly a result of federal price regulation. Conversely, the competitive vulnerability of pipelines with shallow or non-existent cushions is also part of the legacy of statutory price controls.Were we to ignore direct market losses caused by off-system sales by deep cushion interstate pipelines, we might soon find intrastate pipelines in serious financial difficulty and ripe for plucking by their federally subsidized brethren. The acquisition of such intrastate facilities by an interstate company would certainly put to rest in a definitive fashion any claims of mere "market raiding."Nor are we faced with [**20] a situation analogous to the 1970's when federal price controls prevented interstate pipelines from bidding market value prices for gas. During that period, sales by intrastate pipelines to the interstate markets under § 2.68 of our regulations were at higher than average prices. There was no threat to competition because [*61,309-] 2 below-market prices produced rationing and thereby precluded the development of price competition for markets.Finally, as pointed out by Cmmissioner Richard's statement, predatory pricing is forbidden by section 2 of the Sherman Act. n3 While agreeing upon a single definition of predatory pricing behavior may be difficult, there is agreement on the principle that a firm ought not be permitted to abuse a dominant market position by pricing its output so far below its costs as to eliminate its competitors. n4 Such a result would be particularly inequitable if the Commission allowed itself to be in effect an unwitting partner in predation. Nevertheless, this is precisely the result Commissioner Sheldon espouses. It is precisely that insensitivity to predatory conduct, actual and potential, that validates the price structure of our off-systems sales policy. [**21] Far from protecting narrow or parochial concerns, adopting this approach will commit the Commission to the high road of providing the "fair field" for competition which is, and ought to be, our goal.

n3 See Concurring Statement of Commissioner Richard, at 7, n.14.

n4 See generally Areeda and Turner, Predatory Pricing and Related Practices under Section 2 of the Sherman Act, 88 HARV. L. REV. 697 (1975). The question, of course, is what is the measure of "costs" where, as here, a statutory system encourages wide disparities between average and marginal costs among the universe of pipelines. Our policy eliminates the advantages of so-called deep cushion pipelines by placing the off-system sales level at a level at least as high as the pipelines' marginal cost absent considerations of relatively small volumes of very high cost supplies such as deep, tight sands and imported gas.

[*61,309-] 3RICHARD, Commissioner, concurring:The Commission, like poor Pilgrim on the way to the Celestial City, has been seeking light in the instant review of [**28] its off-system sales policy since the Informal Conference held in November of 1982. Our problems with on-system sales are enough, yet we now must consider those that are off-system.Our rules on off-system sales emerged from two policy objectives: to allow supply-rich pipelines to sell gas to supply-poor pipelines to correct regional supply imbalances and to offer interstate pipelines relief from take-or-pay obligations. Regional supply imbalances largely occurred during the curtailments of the [*61,310] 70's with some occurring after enactment of the Natural Gas Policy Act of 1978. The take-or-pay factor in our policy has largely been brought about in the last two years by rising prices during a time of decreased demand. n1 Both reasons for the need for off-system sales can be explained by regulatory policy. n2 Certainly they are not inherently evil.

n1 An economic recovery and concomitant increase in demand could bring the first reason back to the limelight. Conversely, even lower oil prices or a failure of the economy to revive would continue to emphasize reason two.

n2 *See* Office of Regulatory Analysis, F.E.R.C., Off-System Sales: A Preliminary Outline of the Policy Issues, 5-13 (October 12, 1982).

[**29] The picture of our natural gas market from shortage to current surplus has changed considerably since the Central Intelligence Agency in 1977 projected such gas shortages worldwide that the Soviet Union would be a net importer of both oil and gas. n3

n3 Centeral Intelligence Agency, *The International Energy Situation: Outlook to 1985* (1977). The report predicted the Soviet bloc by 1985 ". . . would require a minimum of 3.5 million barrels of imported oil" daily. Soviet production is more than 400,000 above the CIA's estimate for 1983. This estimate was part of the impetus behind President Carter's National Energy Plan.

Since the public conference, concern about the supply-demand imbalance has been mounting. Pipelines, both interstate and intrastate, as well as distribution companies have fervently expressed their concern about maintaining existing sales levels in their conventional market areas. n4 Markets have been deteriorating. According to the most recent American Gas Association data estimates in the calendar year 1982, the amount of excess gas production capability ranged from 1.9 Tcf to 2.7 Tcf. Estimates of our own Staff note that a further drop in the OPEC oil price [**30] to a range of $25, could in turn, increase the surplus even greater. n5 The increasing deliverability surplus issue must be addressed by the Commission.

n4 This Commission is too. *See Tennessee Gas Pipeline Company, a Division of Tenneco Inc.,* 21 FERC P61,004 (October 1, 1982).

n5 Staff suggests markets for gas could fall further below the 1982 levels with a projection of an oversupply for 1983 to be in excess of 3 Tcf, an amount equal to approximately 15% of the total marketable natural gas production. Working and total storage inventories for 37 interstate pipelines are now 45.5 percent (470 Bcf) and 17.5 percent (594 Bcf) higher, respectively than last year at this time. Office of Pipeline and Producer Regulation, F.E.R.C., Preliminary Interstate Form 8 Underground Storage Report (April 1, 1983).

[*61,311] No one knows how long this supply-demand imbalance will last. n6 We all might agree, however, that the dissipation of surplus is linked to such factors as the interaction between natural gas and fuel oil prices as well as a strengthening of the current soft demand in our automobile and steel industries. In the meantime, there still could be a significant number of willing [**31] sellers and willing buyers, who for a number of reasons will be in a position to ameliorate the present and possibly enormous short-term market imbalance.

n6 A study by Merrill Lynch suggests up to 1984. *See Oil & Gas J.,* February 21, 1983, at 66-69.

Thus, I concur with the majority that off-system sales are an acceptable response to a difficult, albeit what may be a short-term, problem. The first place where I differ with my colleagues is in their choice of the pricing mechanism which, in my view, may do very little to facilitate the movement of gas. Nor have we, I think, given enough thought to what chaos might be created if the price of oil drops too precipitously. n7

n7 We are seeing some evidence of this now in the form of refusals to honor minimum bills, or take-or-pays. In a non-regulated market all segments of the national production/delivery system would bear the brunt of a drop in demand to the overall benefit of consumers. Due to the nature of our system, however, in a falling market, we are likely to see requests for rate increases to reallocate fixed costs based on lower demand absent falling prices or reduced take-or-pays.

Price Restrictions on Gas Movement [**32] The off-system sales conference was replete with criticism of the inadequacies of the 100% load factor rate. When this Commission adopted it in August 1981, it was under enormous pressure to do something with the mounting take-or-pay exposure projected by interstate pipelines. On-system customers were willing to wait and see what their posture would be after the experience of the initial year of the off-system sales. By August of 1982, it became apparent that the 100% load factor rate was being seriously questioned. Since most on-system customers were generally unable to purchase at the lower 100% load factor, our review invited comments on what might be a more appropriate benchmark.Numerous participants at the November conference encouraged the Commission to adopt the system average load factor rate since in theory it reflected the average cost of serving the typical on-system customer on a particular system. Since this average load factor is one which is designed to accommodate all on-system customers, it is safe to conclude that such a rate is neither unjust, unreasonable, nor unduly discriminatory insofar as those customers are concerned.A system average load factor rate more [**33] fully compensates traditional customers for the volumes sold off-system. It offers a further advantage to on-system customers if the selling pipeline elects to credit off-system revenues to Account 191. The customers will receive significantly more credited revenue under such a plan compared with the 100% load factor rate. An off-system customer, on the other hand, should benefit by averaging down its higher cost supplies with lower cost off-system amounts.Even this compensatory policy, by itself, could be satisfied and off-system sales allowed, so long as the selling price is greater than the selling pipeline's avoided or incremental cost. That price *could* still be lower than any comparable on-system price. It does not *have* to be the higher of system average load factor or the average Section 102 price.I am afraid our policy may dampen pipeline flexibility to the ultimate detriment of all consumers. These times call for new policies here at the Commission. Surviving the natural gas industry transition will be rocky at best. The review of off-system sales have raised a number of questions of an institutional nature along these lines.It has been argued that interstate pipelines [**34] that have operated efficiently and prudently with regard to gas acquisition strategies should be rewarded by being placed in a position to make off-system sales of a short-term surplus.However, whenever a commodity has been vintaged such as has happened in the wellhead control of natural gas,

existing customers of a pipeline may argue that the low cost supplies financed in effect by them, especially if interest free loans by ratepayers such as advance payments are involved, should be "husbanded" for their use. n8 The use of this grandfather idea advanced by lawyers, legislators, or expressed by physicists in who gets to say when time will start, evidenced by the equation, time = 0 will be an issue here at the Commission.

n8 For example, Joseph P. Thomas of Peoples Gas Lighting Company and North Shore Company said, "The question of the old gas prices—which give Natural Gas Pipe substantial advantage—came about because it had fantastic support from the customer in the early '70s in advanced payment programs. Also, the customers made direct personal investments with producers to commit gas to Natural Gas Pipe."Natural Gas Pipe, therefore, today is in a very enviable position in terms of cost of gas, but they are there because they had the support of their customers. And most of it was financial support." Review of Off-System Sales Program, Public Conference Transcript 283 (November 4, 1982).As Donald Carlson of Interstate Power Company noted, "Curtailment and restriction of growth by Interstate's pipeline suppliers has only ended in the last few years, and these suppliers have offered additional contract quantities to their jurisdictional customers for the first time in approximately 10 to 12 years.Both Northern and Natural have participated very actively in the off-system sales of their reserves and have applied for authorizations to make additional sales in the future. Interstate believes that these applications should be evaluated in the light of the effect that these authorizations might have *on the availability of firm and interruptible service to historic customers on these pipeline systems in the future,* and the impact of authorizing such sales on curtailments in the future." *Id.* at 232.

[**35] This is where the battle is joined. At what price should off-system sales be set in order to be compensatory to on-system sales? n9 Set too high none will be made; set too low and on-system customers might argue their cushion is being eaten up.

n9 The interests of traditional system customers in off-system sales raise a multiplicity of difficulties. Some of these are broad issues such as the extent to which a price should compensate them for depletion of the pipeline's cushion. Other issues are linked to the characteristics of the customer class. For example, in Docket No. CP82-544, customers of Tennessee Gas Pipeline have voiced their displeasure at the proposed off-system sale of 129 Bcf of surplus gas at a 100% load factor rate when many small customers are constrained from purchasing the cheap surplus by their annual volumetric limitation imposed under Tennessee's 1974 curtailment plan. Review of Off-System Sales Program, Supplemental Comments of Am. Pub. Assoc. at 7 (December 2, 1982). Resolution of issues of this sort may range from removal of annual volumetric limitation to rate design adjustments.

As to the husbanding issue, one pipeline executive noted in his testimony [**36] that as to the:. . . perceived low cost advantage at a later date. . . . The gas may not be recovered as a result of drainage or the limited time frame available for make-up or take-or-pay volumes in Natural's gas purchase contracts. n10

n10 Review of Off-System Sales Program, Public Conference Transcript at 7 (November 4, 1982) (Comments by Charles Eberst, Natural Gas Pipeline Company).

The perceived benefits of husbanding may be illusory. [Pipelines] have continued to add reserves. We feel that that's important to the future viability of all of our markets. ". . . this is not the kind of business dealing with a depreciable asset where you can turn it off and turn it back on when you need it. It requires lead time . . ." n11

n11 *Id.* at 63. Lead times are not limited to pipelines—neither acquisition nor *production* comes, like Athene, full blown from the head of Zeus. This Commissioner, and others, still worry about deliverability in the long term:"Transco believes that the excess deliverability situation is necessarily a temporary phenomenon because reserves dedicated to pipelines have not increased substantially in recent years. For example, today Transco reserves/annual production ratio is approximately 6 compared to 10 in 1977. During that same period, Transco's pipeline reserves increased 12 percent, whereas, annual deliverability from these reserves increased 90 percent," *id.* at 328 (comments of Alford White of Transco); or,"[W]e do not believe that there is any magic in maintaining a certain level of gas reserves or a high reserve to production ratio. As a matter of fact, [Lone Star Gas Company doesn't] think that it is reasonable nor practical in today's business environment to maintain the high reserve to production ratios that we were able to maintain 10 to 15 years ago," *id.* at 381 (comments of H.H. Merritt).

[*61,312] [**37] As the band of commodity prices developed under existing statutory authority or (under changed authority) moves towards a much more narrow one, the off-system sales policy has the potential to become a useful tool. Similar to any commodity spot market, it could enable our maturing system of pipelines to move a supply of gas around the country where it is needed much like the idea of a national electrical grid. At the same time it could offer *all* producers the flexibility for *continued* exploration and production through an expanded market access.This purpose will be served

as long as the on-system customers are adequately protected on the price issue. The supply issue is one that takes care of itself in that off-system sales would, of course, be interruptible.As to the implication in the policy statement that there appears to be a competitive problem between interstate pipelines and intrastate pipelines, I would suggest that the problem in the future will not be limited between these two entities alone. The potential for disruption caused by vintaging could be between some interstates against other interstates.As the witness for Northern Natural Gas Company noted:"Since [**38] . . . we have lost a lot of sales during the off-peak period, we are trying to find the markets for our long-term gas supply, that we can't market in our traditional area." n12

n12 *Id.* at 120 (Comments of Othol White of Northern Natural Gas Company). *See infra* note 27.

*Market Raiding*The fact is that any static pricing standard adopted today may soon be irrelevant. The growing surplus of natural gas can become so large that, with rare exceptions, there could be no buyers. n13 Even if the price were set at the "reasonably anticipated average variable cost" n14 (a standard recommended by antitrust experts to avoid predatory pricing) the prices would still approximate the prices of recent sales. The majority has gone farther to consider not only antitrust policies and the need to encourage natural gas sales, n15 but also to take into account the price which does not discriminate against the customer of the selling pipeline and compensates for the loss of the gas. It is true, as the dissent points out, that these steps lessen the likelihood that off-system sales will be made. However, it bears reiteration that the crucial battle relating to the regulatory treatment of [**39] surplus natural gas in the long term is not likely to be joined between intrastate and interstate pipelines as envisioned by the majority. That is merely a skirmish. The Commission is about to become the arena for the interstate pipeline systems as they challenge each other for shares in what may become a rapidly *contracting* natural gas market, absent market pricing comparable to its fuel competition and an upturn in the economy.

n13 For the two week period ending February 19, 1983, only 96,000 Mcf/d moved under the off-system sales program. Office of Pipeline and Producer Regulation, F.E.R.C., Volumes of Self-Implemented Purchases, Off-System Sales and Curtailments by 28 Major Interstate Pipelines, App. IV (March 3, 1983). It is worth noting that the prices for these transactions were lower than the standard adopted by the majority today.

n14 Areeda and Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act,* 88 Harv. L. Rev. 697, 716-720 (1975). *See Pacific Eng. & Prod. Co. of Nevada v. Kerr-McGee Corp.,* 551 F.2d 790 (10th Cir. 1977), *cert. denied,* 434 U.S. 879 (1977), *reh. denied,* 434 U.S. 977 (1977); *Zoslaw v. MCA Distrib. Corp.,* 693 F.2d 870, 887-888 (9th Cir. 1982); *Northeastern Tel. Co. v. Am. Tel. & Tel. Co.,* 651 F.2d 76, 88 (2d Cir. 1981); *Chillicothe Sand & Gravel v. Martin Marietta Corp.,* 615 F.2d 427, 431-432 (7th Cir. 1980).

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n15 As the current surplus builds, it continues to depress drilling and exploration activities. Lawrence, Office of Regulatory Analysis, F.E.R.C., Monthly Gas Industry Activity Rep. No. 29, 1-2 and Charts 1-3 (February 28, 1983).

In the public discussion of this policy statement held on March 10, 1983, some members of the majority defended their choice to protect the intrastate pipelines from market intrusion on the ground that the Natural Gas Policy Act of 1978 had conveyed an unintended, competitive advantage upon some interstate pipelines. I agree that, under that statute, several interstate pipelines possess large reserves of low-cost gas which remain under price controls. Thus, their average prices are lower than others less fortunately situated. n16 In my opinion, however, the effects of "price cushions," dropping demand due to conservation, and market loss to alternative fuels have far more serious implications in the interstate market.

n16 *See* F.E.R.C., Impact of the NGPA on the Current and Projected Natural Gas Markets, 47 Fed. Reg. 19,157 (May 4, 1982).

The front lines of impending combat have already reached the doorsteps of the Commission. On November 24, 1982, [**41] we set for hearing a complaint by Central Illinois Light Company that they be permitted to add a new supplier, displacing some high-priced Panhandle Eastern supplies with volumes from Natural Gas Pipeline Company of America n17 which enjoys the lowest system average acquisition cost in the country. On February 3, 1983, the Illinois Commerce Commission passed a resolution directing Central Illinois Light Company, Illinois Power Company, and Central Illinois Public Service Company to inquire into the feasibility of obtaining natural gas supplies less costly than that available from their current suppliers. n18 In addition, the Illinois Commerce Commission has proposed legislation to the National Association of Regulatory Utility Commissioners that many current natural gas supply contracts be voided or subjected to renegotiation and that would make pipelines common carriers. Under such a scheme, the traditional service obligations

of the pipelines and their role as sole suppliers would be seriously diminished. n19

n17 21 FERC P61,147. The first market entry case decided by the Commission originated in Illinois. In *Central Illinois Public Service Company,* 4 FPC 1043 (1945), the distribution company sought to purchase additional supply from a source other than its traditional supplier, Kentucky Natural Gas Corporation. The distributor, in effect, sought to eliminate the middleman and to purchase directly from Kentucky's supplier, Panhandle Eastern Pipe Line Company.

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n18 Illinois Commerce Commission, Inquiry into Feasibility of Obtaining Alternative Sources of Gas Supply (February 3, 1983) (attached here).

n19 *Illinois Commerce Commission Pushing Common-Carriage Plan, Greater Competition,* Inside F.E.R.C. 3 (March 14, 1983).

Now it appears that it is to be the burden of the Commission to referee the territorial struggles over shrinking territory. n20 In the past, the fights have largely involved opportunities for market growth. In the near future we may be forced to decide who is to be the shrinking pipeline. The Commission has never grappled with the ramifications of market intrusion on an industry-wide basis.

n20 I harbor reservations about the wisdom of protecting market segments, as I have discussed earlier, especially when the protection is grounded in an attempt to compensate for advantages conveyed by a statute which was intended to unify the interstate and intrastate market. However, I view the "tentative" statement issued today as applicable only to off-system sales, not to the broader issues of market competition among long-term suppliers.

The cushion debate again raises its head, not between intrastates and interstates, [**43] but between interstates with low versus high cushions. The differential in price that may [*61,313] lead to a competitive advantage on price alone, absent legislative changes may last until the 1990's. n21

n21 The natural gas cushion is derived from the relationship of decontrolled or to be decontrolled gas and the gas which remains subject to price controls. According to the Department of Energy, approximately 60% of all intrastate gas is decontrolled by 1985, rising to 76% in 1987, and 88% by 1990. In the interstate market, 46% of domestic interstate gas supplies will retain price controls by 1985, 36% in 1987, and 25% in 1990. Office of Policy, Planning and Analysis, U.S. Dept of Energy, *A Study of Alternatives to the Natural Gas Policy Act of 1978* 7 (November 1981) (DOE/PE-0031); Energy Information Administration, U.S. Dept. of Energy, *Intrastate and Interstate Supply Markets under the Natural Gas Policy Act* 12-13 and 27 (October 1981) (DOE/EIA-0039).

A review of some of the leading cases reveals some of the factors which the Commission will have to consider when confronted with the issue of market intrusion. Based upon the Natural Gas Act's directive that certification and [**44] abandonment authority are not to "be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already being served by another natural gas company," n22 the policy of the Commission has been held to favor competition. n23

n22 15 U.S.C. § 717f(g) (1976).

n23 *Lynchburg Gas Co. v. F.P.C.,* 336 F.2d 942, 949-950 (D.C. Cir. 1964) (Washington *concurring:* "Investors in the natural gas industry, although granted an *opportunity* for a 'fair return', are by no means guaranteed freedom from risk or competition. Such assurance would, in a case such as this, deprive competitors of the right to compete, inhibit efficient allocation of resources and deny ultimate consumers the lowest prices to which they are entitled."). *Panhandle Eastern Pipe Line Co. v. F.P.C.,* 169 F.2d 881, 884 (D.C. Cir. 1948), *cert. denied,* 335 U.S. 854 (1948); *Columbia Gulf Transmission Co.,* 37 FPC 118, 131 (1967), *aff'd, Atlantic Seaboard Corp. v. FPC,* 397 F.2d 753 (4th Cir. 1968).

Under that rubric, however, the Commission has generally sought to balance the benefits of the intrusion against its detriments [**45] from the point of view of the affected customers. n24 The chief benefit is generally a lower price, at least in the short-term for some customers. n25 The detriments have received more attention, focusing upon the effect of market loss. n26 Whether this Commission wants to pay attention to any or which of these cases when gas market priced, no longer sells itself against competing fuels will be our task.

n24 *Lynchburg Gas Co. v. F.P.C.,* 336 F.2d 942, 950 (D.C. Cir. 1964) (Washington, *concurring*).

n25 *E.g., Texas Eastern Transmission Corp.,* 14 FPC 116, 120 (1955) (Low cost was found to be outweighed by the effects of load loss on the established supplier.); *Central Illinois Pub. Serv. Co.,* 4 FPC 1043 (1945). Other benefits

have included the extent to which a second supplier can furnish more satisfactory service. *Michigan Wisconsin Pipe Line Co.,* 5 FPC 953 (1946), *amplified,* 6 FPC 1 and 6 FPC 58 (1947). *See Michigan Consolidated Gas Co. v. F.P.C.,* 283 F.2d 204 (D.C. Cir. 1960), *cert. denied,* 364 U.S. 913 (1960) (remanded related proceedings for consideration of the overall needs of the competing companies). A second physical source of supply which enhances the operational flexibility and safety of the purchaser, *Texas Eastern Transmission Corp.,* 14 FPC 118, 120 (1955). Occasionally, when a customer sought to eliminate its "middleman supplier," this has been viewed as a benefit *per se. Cincinnati Gas & Elec. Co. v. F.P.C.,* 389 F.2d 272, 276 (6th Cir. 1968). *Cf. Shrewsbury Mun. Light Department v. New England Power Co.,* 32 FPC 373, 377 (1964), *aff'd sub nom. New England Power Co. v. F.P.C.,* 349 F.2d 258 (1st Cir. 1965) (displacement of original supplier of electric power).

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n26 In *Tennessee Gas Transmission Company,* 14 FPC 544 (1955), for example, the Commission permitted the introduction of a second supplier where the impact on the traditional one would "not be material." *Id.* at 548. On the other hand, it has denied intrusion where the savings to the customers were "relatively small." *Texas Eastern Transmission Corp.,* 14 FPC 116, 120 (1955). It also denied intrusion in *Transcontinental Gas Pipe Line Corporation,* 21 FPC 130 (1959), relying upon the potential harm to the original supplier who had "pioneered" the area. The Third Circuit criticized the reliance of the Commission upon "assertions of possibilities" of economic injury. *Lynchburg Gas Co. v. FPC,* 275 F.2d 847, 848 (3rd Cir. 1960). The Commission responded to the court by later granting the intrusion based upon price benefits.) *Lynchburg Gas Co.,* 24 FPC 955, 958 (1960). The Commission has also refused to permit an additional supplier to skim the cream of the industrial load off the original pipeline system. *Transwestern Pipeline Co.,* 36 FPC 176, 20 (1966); *Natural Gas Pipeline Co. of America,* 34 FPC 771, 782-783 (1965). We have demanded that the supplier seeking entry show independent economic feasibility for the proposed project. *Natural Gas Pipeline Co. of America,* 34 FPC 771, 778 (1965). In two cases the Commission attempted to formulate a mechanical test for balancing these interests. Called the "net market loss test," the theory was first developed by Judge Fahy in his remarks setting forth his reasons for the *per curiam* remand in *Lynchburg Gas Co. v. F.P.C.,* 336 F.2d 942, 947 (1964). It measured the specific potential market loss that intrusion would impose upon the original pipeline in terms of its impact on revenues or growth, but considering whether the historical supplier may increase its sales elsewhere. *Alabama-Tennessee Natural Gas Co.,* 38 FPC 1069, 1073-1078 (1967), *aff'd, Alabama-Tennessee Natural Gas Co. v. F.P.C.,* 417 F.2d 511, 514-518 (5th Cir. 1969); *City of Hamilton, Ohio,* 37 FPC 209, 214 (1967), *aff'd, Cincinnati Gas & Elec. Co. v. F.P.C.,* 389 F.2d 272, 276 (6th Cir. 1968); *Columbia Gulf Transmission Co.,* 37 FPC 162, 125-126 (1967). These decisions were severely criticized in Smith, *The Federal Power Commission and Pipeline Markets: How Much Competition?,* 68 Colum. L. Rev. 664, 681-687 (1968) (argued that the Commission should also protect the original supplier's right to growth in the contested market, *id.* at 666). The courts have since held that this test is not mechanical, but is a factor which the Commission "may" consider. *Atlantic Seaboard Corp. v. F.P.C.,* 397 F.2d 753, 760 (4th Cir. 1968). However, the courts have upheld the Commission's reliance on this test even when the result was to completely supplant the original supplier with a competitor new to the service area. *Alabama-Tennessee Natural Gas Co. v. F.P.C.,* 417 F.2d 511 (5th Cir. 1969); *Cincinnati Gas & Elec. Co. v. F.P.C.,* 389 F.2d 272 (6th Cir. 1968).

[**47] *Conclusion*None of these factors are dispositive in the circumstances I believe the natural gas industry will soon face. On the one hand, widespread market-shifting undermines the planning efforts of management and the confidence of investors. It may also injure customers who, when their numbers are reduced, must shoulder a larger share of the fixed costs. On the other hand, protectionist policies may deprive customers of the lowest prices they might receive and remove the discipline of competition.Naturally the penetration of one's historic market, whether its interstate or intrastate, is a concern. n27 Until the wide band of prices caused by vintaging becomes a much more narrow one, rather than the 27-type (or 24 but who's counting?) structure we have today, this Commission will have to concern itself with charges of market raiding. When the band is tight it would seem reasonable that surplus gas will move freely on a price basis. The notion that you are either a low cushion intrastate or high or low cushion interstate would be meaningless—efficiency, not vintaging, would win markets and bring the lowest prices to consumers. The Natural Gas Policy Act, among other things, [**48] established movement towards a *nationwide* wellhead price rather than one that differs because it is either intrastate or interstate. In this vein, it is well to remember that although the price unregulated intrastate market brought on increased supplies before the passage of NGPA the intrastate market began to saturate. n28 The validity of this statement flows from the fact that over 2 Tcf of gas flowed into the supply short interstate market through Section 311 transactions n29 immediately after passage of the NGPA in 1978. The reasons that were incentives to move gas from intrastate to

interstate are the ones that would encourage interstate pipelines to sell a short-term surplus. A national debating society could be formed stocked with spirited members on both sides on whether or not the intrastate markets unregulated price kept the reserves forthcoming while the interstate markets regulated price discouraged the exploration and development of gas. The NGPA by unifying the wellhead price supposedly did away with that internecine battle. We should, as a national objective, encourage the free flow of gas across our state and national borders at the price that a free competitive [**49] market would produce.

n27 "Mr. Solters: To the extent that people would want blanket transactions, . . . for off-system sales which would permit the selling interstate pipeline to sell gas in somebody else's market, because there aren't any new plants, basically, they are all pretty much tied up—would you be willing to, as a part of that package, look at accepting a condition under which you would transport other people's gas into *your* markets at a particular point in time?""Mr. Davidson: I can answer that for Consolidated Mr. Solters. . . . We wouldn't reject it out of hand. We would want to look at what impact it has on our system and on our fixed cost recovery by moving that gas. But again, it would have to be a cooperative effort. Just as when we go out and find off-system markets, we have to also get cooperation from intrastate companies to move that gas to those markets." Review of Off-System Sales Program Public Conference Transcript, 128 and 132 (November 4, 1982). Plenty of concern by intrastate pipelines is contained in the transcripts.

n28 A reconstruction of contract prices in graph form would also show the price beginning to break downward.

n29 15 U.S.C. § 3371 (Supp. IV 1980).

[**50] In my view, tentative attempts to resolve these conflicts and contain the struggle to isolated situations, such as today's policy statement, should be avoided until the Commission or Congress has analyzed the larger ramifications and is prepared to address them—the quicker the better. Hopefully any policy developed will rely less on historic regulatory expertise and rely more on hard bargaining where market signals do get sent *up and down* the line.

DISSENTBY: SHELDON

DISSENT:

SHELDON, Commissioner, dissenting:I disagree with my colleagues in this matter because I believe implementation of the policy will prevent surplus gas from being made available to many prospective purchasers. Further, I believe the lease cost gas mix will not be available to consumers. [**22] Industry data indicates that there is presently a deliverability surplus in excess of 3 Tcf. Current market demand forecasts demonstrate that the amount of the present surplus may grow even larger. Given OPEC's most recent developments, it is not unreasonable to assume that No. 6 fuel oil may further erode additional industrial markets served currently by natural gas. Notwithstanding the fact that natural gas has at best a tenuous hold on some industrial markets, there is ample evidence that certain areas of the country contain industries that are unable to shift, for pragmatic reasons, to fuel oil or are supplied by expensive sources of natural gas. If it is possible to move some of the surplus to markets efficiently and without undue harm to on-system customers, it is my belief the Commission should facilitate such movement.While the policy statement issued today seeks to deal with this surplus situation, I believe the policy adopted by the Commission does not achieve its stated objectives.I am particularly concerned with the pricing scheme established by the policy statement. While it is intended to preclude off-system sales made at discriminatory or preferential prices to the [**23] detriment of on-system customers, it is in my view both unnecessary as a protective measure and inimical to the majority's stated objective of moving less expensive gas to off-system markets.The past 11/2 years has indicated that gas will move if it is appropriately priced. Clearly the 100 percent load factor rate resulted in the movement of several billion cubic feet of gas. When the 100 percent load factor was adopted as a policy matter to be in the public convenience and necessity, the Commission believed such a rate was a fair and just pricing scheme. However, we have seen several on-system customers object to the 100 percent load factor because it was not a rate under which the on-system customers could purchase gas for their own use.I would generally prefer to see this Commission give the selling pipeline and its on-system customers the freedom to determine what off-system sales rate would adequately protect these customers. A system average load factor rate is one which would reflect the average cost of serving all on-system customers and would be a rate under which all on-system customers could make purchases. Such a rate is clearly not unjust, unreasonable nor unduly discriminatory [**24] or preferential with regard to on-system customers. In my view, a system average load factor rate would be presumptively in the public convenience and necessity. Further, a system average load factor rate would recover more revenues for on-system customers than the 100 percent load factor rate. Moreover, the record indicates that virtually all of the Louisiana intrastates could continue to purchase vast quantities of the surplus at significant savings to their customers if the selling interstates are authorized to sell gas off their traditional system at the system average load factor rate.The majority appears to have de-emphasized

the off-system sales policy's original goal of reversing a dangerous trend of discouraging producers from continuing their aggressive exploration and development program initiated subsequent to the passage of the NGPA. The system average load factor rate would allow some of the interstates with the largest surpluses to continue their off-system sale efforts. The point is, gas will move off-system without undue harm to on-system customers if it is appropriately priced. The majority's action today will do nothing to ameliorate the current dilemma.I am concerned [**25] also with that part of the policy statement which requires case-specific analysis of situations where a proposed off-system sale is alleged to cause market loss by an established supplier. The mere specter of prolonged litigation will discourage potential sellers from attempting to negotiate an off-system sale.Another aspect of the policy statement with which I have problems is the requirement that the selling pipeline has actual or potential take-or-pay obligations. Such a requirement penalizes a well managed company which may have surplus supply not necessarily coupled with take-or-pay potential. A perhaps less efficient company with take-or-pay problems would be rewarded by this requirement but an efficient company would be penalized.The majority appears to imply that there is something ominous about interstates displacing pre-existing intrastate suppliers because of the "cushion" afforded interstates by virtue of the NGPA.Let me set the record straight by making the following observations: From the onset of interstate curtailments in 1971 to as recently as two years ago, certain intrastate pipelines have enjoyed significant supply advantages to the detriment of the interstate [**26] market. A major ingredient which spawned the intrastate surplus was the absence of any price control. However, this absence of controls enabled intrastate suppliers to offer firm, reliable supplies to the intrastate industrial and boiler fuel markets. Moreover, countless industrial customers of interstate pipelines faced with the option of no gas willingly relocated their plants to the gas rich intrastate arena. Further, immediately upon passage of NGPA, these same intrastate pipelines, who today the majority seeks to insulate from the rigors of the marketplace, capitalized considerably under Sections 311(b) and 312 of the NGPA. Enormous volumes of surplus intrastate gas moved into the gas-starved interstate market without a mention of market raiding or anticompetitiveness.It is shortsighted to assume that today's interstate surplus is any more permanent than was the intrastate surplus of several years ago. Given the severe supply decline curves forecast for the Gulf of Mexico as early as 1985, it is unfortunately not unreasonable to assume that a new era of curtailment is lurking beyond the horizon. Off-system sales are only a temporary and short-term response to the myriad factors [**27] which have caused the current deliverability surplus. To deny appropriate market responses for parochial reasons is a policy I cannot support. Further, to suggest that the cushion is a creature of the statute flies in the face of the history of contractual and regulatory practices in the intrastate market. It has been next to impossible for intrastates to acquire low-cost gas on a permanent basis since virtually every intrastate contract contains favored-nations' clauses which cause all intrastate prices to rise according to the highest price which any intrastate buyer is willing to pay. Interstates today might be facing the same prospect had not the Commission explicitly acted to prohibit the operation of these clauses in interstate contracts.I favor an off-system sales policy which has the Nation's best interests at heart, not a policy which has the peculiar, if not odious effect of safeguarding parochial concerns. The majority should state simply that it has decided to discontinue the off-system sales program. In effect, it has.

APPENDIX:

Attachment

*Order*WHEREAS, certain natural gas pipelines serving gas distribution companies in Illinois are purchasing significant quantities of high-priced gas; andWHEREAS, the average purchase gas cost of these pipelines with high-priced gas is now far above the price of new domestic gas and the price of gas on other pipeline systems; andWHEREAS, information available to the Illinois Commerce Commission indicates that ample supplies of less costly gas are available; andWHEREAS, these high-cost gas purchases by certain natural gas pipelines are imposing and will continue to impose severe and unnecessary financial burdens on natural gas customers in Illinois; andWHEREAS, Central Illinois Light Company, Illinois Power Company [**51] and Central Illinois Public Service Company are particularly affected by pipeline purchases of high-cost gas;ACCORDINGLY, the Commission, pursuant to Sections 8, 9, 36 and 41 of the Public Utilities Act, directs an inquiry into the feasibility of obtaining alternative sources of gas supply. Central Illinois Light Company, Illinois Power Company, and Central Illinois Public Service Company should each file a written report with the Commission on the feasibility of obtaining alternative sources of gas supply. In such reports the companies shall address at a minimum, the technical, regulatory, and economic feasibility of the following alternatives: (1) direct interconnection with pipelines other than those that presently serve them; (2) increased purchases of gas from pipelines with lower cost gas that are presently serving them; (3) direct purchase of gas supplies from producers or other sources of supply; and (4) coordination of gas purchases among distribution companies in Illinois.IT IS THEREFORE ORDERED by the Illinois

Commerce Commission that Central Illinois Light Company, Illinois Power Company and Central Illinois Public Service Company, be, and they are hereby, directed [**52] to each file a written report on the feasibility of obtaining alternative sources of gas supply, as described hereinabove, with the Chief Clerk of the Commission thirty (30) days from the service date of this order.By Order of the Commission this 3rd day of February, 1983.

Philip R. O'Connor, Chairman