IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 92-4066

TRANSCONTINENTAL GAS PIPE LINE CORP.,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

ON PETITIONS FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF JURISDICTION

This Court has jurisdiction to review the Commission's orders under Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

STATEMENT OF THE ISSUES

1. Whether the Federal Energy Regulatory Commission ("Commission" or "FERC"), having properly found that Transcontinental Gas Pipe Line Corporation ("TGPL") had violated the the Natural Gas Act ("NGA"), 15 U.S.C. 717 et seq., imposed a lawful remedy for such violation.

2. Whether the Commission properly rejected claims of North Carolina Utilities Commission ("NCUC") and the Long Island Lighting Company ("LILCO") that the Commission should have imposed further remedies, and the claim by NCUC that it was prejudiced by an alleged ex parte contact.

STATEMENT OF THE CASE

I. Introduction: Nature Of The Case

In this case, the Commission found that TGPL engaged in a series of transactions that violated the NGA and overcharged its regulated customers by forcing them to subsidize TGPL's losses on sales in the spot market for gas. First TGPL, through its affiliates, sold gas in the unregulated market at prices below its cost and the filed rate for the gas. 1/ TGPL then bought even lower-cost gas that it was already under a contractual obligation to purchase from producers with revenues derived from the illegal sales. TGPL recorded this replacement gas, not at its actual cost, but at TGPL's much higher filed rate. When TGPL attempted to pass through to its regulated on-system customers the difference -- approximately $75 million -- between the cost of its replacement gas and its filed rate, the Commission denied this passthrough.

II. Course Of Proceedings And Decisions Below.

1. The proceedings below were divided into two phases. In Phase I, relating to charges that TGPL had violated the NGA, an Administrative Law Judge (ALJ) found that TGPL's discounted sales

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1/ Section 4(d) of the NGA prohibits natural gas companies such as TGPL from selling gas for resale in interstate commerce at any rate other than one that is on file with the Commission. This is commonly known as the "filed rate doctrine." See Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 578 (1981) ("[T]he Act bars a regulated seller of natural gas from collecting a rate other than the one filed with the Commission . . . ."). A pipeline's filed rate contains as one of its key elements its cost of purchased gas. See, e.g., El Paso Gas Co. v. FERC, 677 F.2d 22, 23 (5th Cir. 1982).

of its system supply gas violated Section 4(d) of the NGA, 15 U.S.C. 717c(d), because they were made below TGPL's filed rate. Transcontinental Gas Pipe Line Corp., "Initial Decision--Phase I," 44 FERC ¶ 63,016 (1988), R. 8413-8428. The ALJ also concluded that because TGPL's discounted sales were made only to "noncaptive" customers -- customers with readily available, competitively priced alternative sources of gas -- TGPL unduly discriminated against its "captive customers," in violation of Section 4(b) of the NGA. Finally, because certain volumes of the below-cost sales had been made to TGPL's off-system customers without a certificate, the ALJ found that these sales also violated the certification requirements of Section 7(c) of the NGA.

In Phase II, relating to the issue of remedies, the ALJ found that TGPL should not be allowed to pass through to its jurisdictional customers $75 million in proposed surcharges, based on TGPL's inflated "recorded" costs, because they exceeded the actual cost TGPL paid for the replacement gas with revenues derived from its illegal sales. He also recommended that the Commission require TGPL to disgorge the approximately $36 million including interest in net transportation revenues TGPL earned by making these unlawful sales. Transcontinental Gas Pipe Line Corp., "Initial Decision--Phase II Remedies," 49 FERC ¶ 63,032 (1989), R. 9300-9325.

2. In an opinion issued on September 12, 1990, the Commission affirmed the ALJ's decision. Transcontinental Gas Pipe Line Corp., "Order Affirming Initial Decision," 52 FERC ¶ 61,248 (1990), R. 9936-9950. On rehearing, however, the Commission set aside the ALJ's recommendation requiring TGPL to disgorge $36 million in transportation revenues in light of conditions in the gas industry prevailing at the time of TGPL's violations. Transcontinental Gas Pipe Line Corp., "Order Denying Rehearing in Part and Granting Rehearing in Part," 58 FERC ¶ 61,023 (1992), R. 10508-10533. On further rehearing, the Commission upheld its prior rehearing order. Transcontinental Gas Pipe Line Corp., "Order Denying Rehearing," 58 FERC ¶ 61,289 (1992), R. 10550-10556. Accordingly, under the final disposition of this case, the Commission refused to allow TGPL to pass through $75 million to its customers, representing compensation to TGPL in excess of its actual cost of gas.

III. Statement of the Facts

A. The Initiation Of The Proceedings In This Case

This case commenced on May 16, 1986, when TGPL filed a proposed settlement with the Commission on a variety of issues related to its transition to an "open access transporter" pursuant to Commission Order No. 436. 2/ When a number of

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2/ [1982-1985 Regulations Preambles], FERC Stats & Regs, ¶ 30,665 (1985). Under Commission Order No. 436, which became effective on November 1, 1985, the Commission granted pipelines blanket authority to transport gas on behalf of others provided that they agree to offer such transportation services on an "open access," nondiscriminatory basis. 18 (continued...)

parties objected to TGPL's proposed passthrough of $75 million of alleged unrecovered purchased gas costs in TGPL's purchased gas account ("PGA" or "Account No. 191"), 3/ the Commission severed that issue along with questions concerning TGPL's past purchasing practices and remanded these issues to an ALJ. Transcontinental Gas Pipe Line Corp., 36 FERC ¶ 61,286 (1986), R. 5959-5961. On September 15, 1987, following an initial decision on remand, the Commission issued an order in which it found that the

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2/(...continued)
C.F.R. § 284.221.

At all times relevant to this case, the "open access" nondiscriminatory transportation policies of Commission contained in Order No. 436 were not applicable to TGPL. TGPL had a "non-sales displacement transportation policy" in effect which meant that TGPL would not provide transportation services on behalf of a supplier or customer where the transaction would displace a sale of system supply by TGPL. R. 2700, 2874.

3/ Under Commission regulations in effect in 1985, a pipeline was permitted to file a purchased gas adjustment (PGA) every six months to reflect in its FERC Account No. 191 any variance between actual gas costs for the past six months and the estimated base rate. See e.g. El Paso Natural Gas Co. v. FERC, 677 F.2d 22, 23 (5th Cir. 1982). See also R. 3830-31.

When actual gas costs exceeded the estimated rate during a six-month PGA billing cycle, the deficiency between the base rate and actual costs was collected as a surcharge during the following six months. Conversely, when gas costs were exceeded by the estimated base rate, overrecoveries were refunded through a credit during the next six month period. R. 3830-31. This estimated rate (including any surcharge or credit) was also known as the "filed rate."

Costs passed through PGAs are provisional only and are subject to review, revision, and refund, both prospectively and retroactively, when the pipeline's rates are reviewed under Section 4 or 5 in its next general rate case. See Associated Gas Distributors v. FERC, 706 F.2d 344, 345-46, 348 (D.C. Cir. 1983).

questions raised regarding the propriety of certain transactions between TGPL and two of its marketing affiliates had not been adequately probed by the ALJ, and it therefore remanded the proceedings for further hearings. In addition, because evidence presented at the hearing on remand suggested that TGPL may have committed violations of the NGA, the Commission ordered the Enforcement Section of its Office of General Counsel to participate in the hearing on remand. Transcontinental Gas Pipe Line Corp., 40 FERC ¶ 61,332, at p. 61,788 (1987), R. 7067-7072.

B. The Hearings Before The ALJ

1. The Market Conditions In Which the Transactions At Issue Took Place

As the evidence adduced below establishes, in 1985, the time frame relevant to this case, there were essentially two sources of gas supply available to the "jurisdictional" customers of pipelines. 4/ The first was pipeline system supply--gas purchased by pipelines to serve their resale customers R. 3237, 3239, which pipelines could lawfully sell only at rates on file with the Commission. See Section 4(d) of the NGA. 5/ The

4/ During the time frame relevant here, "jurisdictional" or "on-system" customers were customers, such as local distribution companies, which purchased pipeline gas supply for resale in interstate commerce pursuant to a certificate of convenience and necessity issued by the Commission under Section 7(c) of the NGA. See also NGA § 1(b); Panhandle Eastern Pipe Line Co. v. Public Serv. Comm'n, Indiana, 332 U.S. 507, 517 (1947).

5/ The Commission requires "rolled-in" pricing for system supply gas, which means that pipelines must price this gas in their rates at its "weighted average cost of gas" (WACOG). See generally CSG Exploration Co. v. FERC, 930 (continued...)

second was spot market supply--gas acquired by resale customers directly from producers or gas marketers, which therefore was not subject to regulation under the NGA and could be sold by the producers or marketers at whatever price the market would bear. R. 3126, 3128-30, 3828. 6/

TGPL's actions at issue here took place against the following regulatory background. During a period beginning about 1982, pipelines began to face softening demand for their gas supplies due to a recession, price competition from alternative fuels, and non-responsiveness of regulated gas supplies to market signals. See e.g., Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985). In addition, they faced increasing exposure to take-or-pay liability due to their inability to meet minimum take requirements of their supply contracts with producers.

In an effort to alleviate some of these problems, the Commission approved "special marketing programs" (SMPs) on a temporary, experimental basis. Under these programs, the Commission allowed pipelines to release unneeded gas subject to

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5/(...continued)
F.2d 1477, 1483 n.3 (10th Cir. 1991); see also Laclede Gas Co. v. FERC, 722 F.2d 272, 274-75 (5th Cir. 1984).

6/ Unless deregulated as of January 1, 1985, see Section 121 (a) of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3331, this gas was subject to NGPA price ceilings that varied depending on its statutory classification. See NGPA §§ 102-109. However, at times relevant to this case, the market-clearing price was below the NGPA ceilings, and, thus, spot market gas prices were determined largely by competition among producers and marketers.

high take-or-pay requirements for sale by producers or marketers in the spot market at market-responsive prices. Once the gas was released, and sold, pipelines could then transport it under temporary or blanket certificates to end users who were not captive customers of the pipeline. 7/ In June 1983, the Commission authorized TGPL and its suppliers to participate in the SMP program. See e.g., Producer-Suppliers of Transcontinental Gas Supply Corp., 23 FERC ¶ 61,460 (1983).

In September 1984, seeking to ensure that resale customers would also have access to cheaper released producer gas, the Commission conditioned extension of SMPs upon pipelines agreeing to grant their firm resale customers, including captive customers, access to volumes of released gas equivalent to 10 percent of the customers' firm sales entitlement, i.e., 10 percent of the maximum volume of gas that the customers could demand. Tenneco Oil Co., 28 FERC ¶ 61,383 at 61,690 (1984) (Ordering Paragraph (11)(a)).

TGPL did not accept these conditions. Instead, it proposed a compromise SMP, known as the "DS" program, under which all of its customers could purchase, and have transported by TGPL, up to three percent of their firm sales entitlement without qualification, and could purchase an additional seven percent of their contract entitlement if they purchased certain "threshold levels" of TGPL system supply gas. The Commission approved

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7/ Transportation-only services by pipelines on behalf of end users required prior authorization from the Commission under Section 7(c) of the NGA.

TGPL's DS program on March 27, 1985. Transcontinental Gas Pipe Line Corp., 30 FERC ¶ 61,322 at 61,637 (1985). However, because the record in TGPL's DS proceeding had been filed on appeal of the Commission orders in that proceeding in the D.C. Circuit, the DS proceeding was technically no longer subject to the Commission's jurisdiction. 8/ For this reason, the Commission explicitly stated in its March 27, 1985 order that its order would not become effective "unless and until leave of the [D.C. Circuit] is obtained . . . to permit Transco to implement the authority granted herein." 30 FERC at 61,141-42.

2. TGPL's Scheme To Sell Gas Illegally In Violation Of The "Filed Rate" Doctrine And Without A Section 7(c) Certificate

When the D.C. Circuit had not acted on the Commission's request for leave by April 1985, TGPL took matters into its own hands. At first, TGPL's corporate parent, Transco Energy, directed TGPL's marketing affiliate, Transco Resources, Inc. ("TRI"), to sell "nonjurisdictional" released gas at market-responsive prices--a lawful transaction. 9/ Under this program, TGPL would transport gas on behalf of TRI pursuant to special NGPA § 311 blanket transportation authorization. R. 7890.

8/ See Section 19 of the NGA, 15 U.S.C. § 717r.

9/ This "nonjurisdictional" gas purportedly consisted of gas released by TGPL to avoid take-or-pay liability, which, in effect, allowed it to be sold in the spot market at market-responsive prices. As discussed infra, TGPL soon began marketing, through TRI, non-released jurisdictional system supply under a pretext that it was nonjurisdictional released gas or spot market supply.

TRI began marketing this gas under its "nonjurisdictional" plan primarily to TGPL's noncaptive customers in April 1985. R. 3260. Demand for this gas immediately exceeded TRI's supply. Without informing its customers, TGPL soon began delivering "jurisdictional" gas from its system supply reserves to them through TRI at the same low market-responsive prices. R. 3267. TGPL received no payments from TRI for this system supply gas; in addition, TRI had made no arrangements at this time to return the gas to TGPL. R. 2817, 3282-84.

In May 1985, officers of TGPL and its corporate parent specifically decided to continue its sales of TGPL's system supply gas through TRI at prices that were below TGPL's filed rate. R. 3269-70. In addition, because TGPL wished to sell even higher volumes of its system supply gas than TRI's marketing efforts could accommodate, TGPL's corporate parent established TEMCO to market surplus gas from TGPL and other sources. R. 7823-24.

As it turned out, the D.C. Circuit never sanctioned TGPL's DS program. Instead, on May 18, 1985, the D.C. Circuit issued its decision in Maryland People's Counsel, 761 F.2d 768 (D.C. Cir. 1985) (MPC I), vacating Commission orders approving an SMP similar to TGPL's earlier SMPs. In the D.C. Circuit's view, the Commission had acted arbitrarily and capriciously by approving

SMPs that allowed pipelines to deny captive customers access to the cheaper spot market supplies under the program. 10/

Undeterred by this judicial decision, TGPL continued delivering its system supply gas to noncaptive customers at below-cost prices throughout the summer of 1985. 11/ Between April and August 1985, TGPL delivered 49.5 million Dth of TGPL's system supply, accounting for 65% of the volumes TRI sold. R. 7831-33, 9766-67. In addition, in June 1985 TGPL began delivering jurisdictional gas to non-captive customers through below-cost sales by TEMCO. These sales lasted until November 1985, and amounted to 48.3 million Dth, or 32% of TEMCO's sales volumes. R. 7831-33, 9766-67. 12/

10/ In Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985) (MPC II), decided that same day, the Court vacated a Commission program granting blanket authorization for pipelines to transport spot market gas on behalf of certain end users without offering similar transportation to captives, because the Commission had slighted its "prime constituency," namely, captive customers, by "failing to evaluate the anticompetitive consequences" of its transportation program.

11/ Despite its similarities to the DS program, TGPL's marketing of system supply through affiliates represented a drastic departure from all SMP-type programs previously approved by the Commission. Unlike TGPL's sale of system supply here, which had not been released to the spot market, the DS program and all other SMPs involved sales by producers or marketers of released gas no longer regulated by the NGA. Thus, there were illegalities present in this case that were not involved in the MPC I and MPC II cases.

12/ The remaining volumes of TRI and TEMCO gas (i.e., not involving TGPL's system supply) were lawful nonjurisdictional sales not under challenge here. R. 2828. These sales did not give rise to any of the so-called transportation imbalances at issue in this case. See R. 2838-41.

As noted, customers which bought the "cheaper" supplies through TRI and TEMCO at market-responsive prices thought they were getting lawfully released gas. R. 2772. None was aware that what it was actually receiving was gas dedicated to TGPL's system supply. Id. TGPL generated some $36 million including interest in transportation revenues from these sales of its system supply gas.

3. TGPL's Attempt To Exploit The NGA Regulatory Structure To Shift The Financial Consequences Of Its Below-Cost Sales To Its Jurisdictional Customers

TGPL's diversion of its jurisdictional system supply gas to the non-NGA-regulated segment of the gas market had a direct and adverse effect on all of TGPL's jurisdictional customers, captive and noncaptive. The weighted average cost (WACOG) of TGPL's jurisdictional gas at the time of the below-cost sales was approximately $3.30 per Dth. R. 302, 8415. 13/ However, TRI sold TGPL's gas below cost for approximately $2.55 per Dth during that same period. R. 9661. Similarly, TEMCO sold TGPL's jurisdictional supply below cost for $2.23 per Dth. Id. If TGPL or its corporate parent had required TRI and TEMCO to remit to TGPL the proceeds of these sales, TGPL would have been faced with an underrecovery of $75 million due to the difference between the

13/ Throughout the period, TGPL's "filed rate" was $3.01 (R. 7839), which meant that TGPL would collect the difference between the $3.30 and $3.01 on every Dth of system supply sold from its jurisdictional customers -- captive and non-captive -- through an Account No. 191 surcharge. TGPL was permitted to collect this difference, and this amount is not at issue in this appeal. See note 19, infra.

actual cost of the gas sold and the lower prices TGPL charged for it.

TGPL sought to avoid these losses by arranging with TRI and TEMCO to be repaid in gas rather than the revenues that TRI and TEMCO collected from the below-cost sales. Thus, in May and June 1985, TGPL directed TRI and TEMCO to prepay TGPL's producers for certain "high-cost" gas supplies, which TGPL was under a contractual obligation to take for \$13-\$14 per Dth, but which were not scheduled for production until the fall of 1985. When this gas was eventually produced, it was understood that TRI and TEMCO would turn it over to TGPL as replacement gas for the system supply that TGPL originally sold through them. As consideration for the prepayments, TGPL's producers agreed to lower their prices to market-responsive levels.

TRI and TEMCO accordingly prepaid for "replacement" gas with proceeds from the unlawful sales of TGPL's system supply gas. As it turned out, the affiliates paid the same prices for the equivalent volumes of the "replacement gas" as they received in the sales of TGPL's system supply. R. 3305, 3370. 14/ After the prepaid gas had been produced and delivered to TGPL at no cost, R. 7819A-7820, TGPL sold the replacement gas in regular system supply sales from September 1985 through April 1986 at its filed rate of \$3.01 Dth, plus the applicable Account No. 191

14/ TRI paid TGPL's producers approximately \$2.55 per Dth for volumes to be delivered to TGPL beginning in September 1985. R. 9677. Similarly, TEMCO paid TGPL's producers approximately \$2.23 per Dth for volumes to be delivered beginning November 1985. R. 9677.

surcharge then in effect. R. 2820. See note 3, supra. This period included the winter heating season, a time when it was easy for TGPL to sell system supply gas.

TGPL accounted for its sales of the replacement gas in a manner that precluded its customers from benefiting from the actual low cost -- \$2.55 Dth and \$2.23 Dth -- that the TGPL corporate family had paid for it. For accounting purposes, the cost TGPL assigned to this gas was not the actual cost to its affiliates; rather, TGPL recorded the cost at its then current filed rate of \$3.01 Dth. R. 2079-80.

By recording the purchase of the replacement gas at this inflated cost, TGPL attempted to pass through to its jurisdictional customers the difference between its filed rate and what the replacement gas actually cost--or \$75 million. 15/ If the Commission had allowed passthrough, the cost of gas to TGPL's jurisdictional ratepayers would have been \$75

15/ This also happened to be the same amount by which TGPL failed to recover its cost as a result of below-cost sales through TRI and TEMCO.

million 16/ higher than if the actual cost of the replacement gas had been included in TGPL's rates. R. 9678.

C. The Initial Decisions Of The ALJ

1. Phase I: The ALJ's Initial Decision On TGPL's Liability

In an initial decision issued on August 29, 1988, addressing only liability issues, the ALJ found that TGPL had operated as a single entity with TRI and TEMCO to exploit the dual market for gas. The ALJ concluded that TRI's and TEMCO's sales of TGPL's system supply gas were actually below-cost sales made directly from TGPL as seller to TRI's and TEMCO's customers as purchasers, in violation of the filed-rate requirements of Section 4(d) of the NGA. In addition, the ALJ found that, because some of TGPL's system supply gas had been sold through TRI and TEMCO to "off-system" resale customers, *i.e.*, to customers to whom TGPL had not received Commission authorization to sell gas, these sales violated NGA § 7(c). *See* R. 8422; 44 FERC at p. 65,056.

In the ALJ's view, there was ample support for this one-company approach. R. 8420-22. He observed that the composition

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16/ TGPL had actually recorded this allegedly unrecovered cost as $78.7 million, which was part of the unrecovered $81 million PGA balance TGPL initially sought to recover from its jurisdictional customers. However, upon reaching the proposed settlement in May 1986, TGPL agreed to forego $6 million of this amount. *See* R. 3831.

Thus, for purposes of this case, the ALJ, the Commission, and all of the parties have referred to this amount as $75 million. To avoid confusion, this brief also refers to TGPL's unrecovered purchased cost balance as $75 million, even though TGPL may have originally computed it as $78.7 million.

of the TRI, TEMCO, and TGPL's corporate hierarchies was virtually identical and that TGPL had often overlooked corporate distinctions in carrying out its sales-and-repurchase scheme. R. 8420-21. In the words of the ALJ:

> Arrangements between the subsidiaries [of TGPL's corporate parent, Transco Energy] were wholly informal. The pipeline's chief witness, also an officer of TRI, could not even remember his title with the subsidiary. These multi-million dollar transactions all occurred under a "general oral agreement" without any legal instruments or written agreements governing . . . the "loans" or their "repayment."

R. 8421; 44 FERC at p. 65,055. The ALJ also found that on occasion it was TGPL which had approached producers and arranged with them to accept prepayments from TRI. R. 8421. He further noted that on another occasion, a customer returned an executed TRI contract not to TRI, but to TGPL itself. Id.

The ALJ also concluded that the transactions at issue were sales, and not, as TGPL had claimed, "transportation imbalances" -- a term generally used to describe situations that arise inadvertently when transportation customers of a pipeline take more gas from the delivery end than they cause to be injected at the supply end. 44 FERC at p. 65,054.

As he explained, this case was entirely different because it involved, not transportation, but "the sale in interstate commerce of natural gas for resale," governed by the NGA. Id.; see also NGA § 1(b), 15 U.S.C. 717(b). The ALJ also noted that under settled precedent the term "sale," within the meaning of NGA §1(b), is construed in the "conventional" or "ordinary usage" sense. Id. (citing Mobil Oil Corp. v. FPC, 463 F.2d 256, 259-263 (D.C. Cir. 1971), cert. denied, 406 U.S. 976 (1972)). As he went on to explain, Section 2-106(1) of the Uniform Commercial Code defines sales as the "transfer of title for a price." Applying this definition, the ALJ concluded that there had been a transfer of title for a price, and that therefore the transactions did not involve transportation imbalances but were clearly sales. 17/

In these circumstances, he found that TGPL had deliberately used its affiliates to circumvent the filed-rate requirements of Section 4(d) of the NGA, in order to sell its gas on the spot market below its cost. R. 8422. In sum, the ALJ stated:

> Treating the companies as one for present purposes, it is plain that the pipeline sold its system gas to various buyers at various prices. Any other conclusion would, as Enforcement points out, allow natural gas companies broadly to evade the Act's regulatory requirements by creating affiliates and acting through them. In this case, there was really one natural gas company making sales in interstate commerce for resale. Such sales required certificates and could occur only at posted tariff prices. Insofar as they did not, there were violations of Sections 7(c) and 4(d) of the Natural Gas Act.

R. 8422.

Turning to the issue of discrimination, the ALJ noted that TGPL had conceded that the discounted sales through TRI and TEMCO

17/ Because TGPL, TRI, and TEMCO were properly viewed as one company for the purposes of the transactions at issue, the ALJ concluded that "there was a conventional sale in every sense of the word: one company (the pipeline) simply transferred its gas to the customers in exchange for money." R. 8420.

to noncaptive customers had discriminated against TGPL's captive customers (R. 8422-23). He therefore found that TGPL had the burden of proving that the discrimination was not "undue" within the meaning of Section 4(b) of the NGA. R. 8423. Relying on the D.C. Circuit's MPC decisions, see supra pp. 10-11, the ALJ observed that "[a] distinction between captive and non-captive customers is inherently suspect, and must be specially and particularly justified." R. 8423; 44 FERC at p. 65,056.

The ALJ rejected TGPL's efforts to justify its discrimination against its captive customers by showing that the sales through TRI and TEMCO had allowed it to increase its purchases, thereby bringing cheaper gas into its mix and reducing the overall cost of gas that captive customers had to pay. R. 8424-25. In the ALJ's view, TGPL had not established that discriminatory pricing was the only way to achieve the benefits of lower prices for captive customers. R. 8425. In addition, the ALJ reasoned that it was entirely possible for TGPL to have achieved significant reductions in its purchased gas costs without embarking on a discriminatory, below-cost sales scheme:

> After November of 1985, when the sales in question stopped, the pipelines' system gas costs went down. The company itself recognized that during that time it "was able to make some progress with gas costs over the winter . . . . Moreover . . . the pipeline also failed to show that these "benefits" were not canceled out by later returns of gas. If the subsidiaries' sales of TGPL system gas originally freed the pipeline to stock up on cheaper gas, their subsequent return of gas should then have prevented the pipeline from later buying cheaper gas. The company made no effort to demonstrate that

> the former "savings" exceeded the latter "losses."

R. 8425; 44 FERC at p. 65,057. Finally, the ALJ also rejected TGPL's claim that discriminatory transactions were necessary to maintain its "Market Maintenance Program ("MMP"), 18/ and thereby produce reductions in its take-or-pay liability. He noted that TGPL had not shown that it could not have obtained similar savings in other ways. Id. Accordingly, he concluded that "[t]he company has failed to rebut the presumption that [its] anticompetitive discriminatory pricing is undue." R. 8426.

2. **Phase II: The ALJ's Initial Decision On Remedies**

On December 15, 1989, the ALJ issued a decision in Phase II, the remedies phase of this case. He essentially relied on the testimony of two witnesses presented by the Commission's Enforcement Section, which had the burden of proof on remedies: Robert Fulton, a staff accountant, and Gloria Halstead, a staff auditor. Fulton's proposal required TGPL to adjust its purchased gas accounts to reflect the actual cost of the gas returned to TGPL by TRI and TEMCO, instead of the inflated cost "recorded" by

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18/ TGPL's Market Maintenance Program was a cost containment program in which TGPL encouraged its producers to grant price relief in exchange for a priority over other producers in making sales to TGPL. See Transcontinental Gas Pipe Line Corp., 30 FERC ¶ 61,322 at 61,639 (1985). It was non-binding upon TGPL in the sense that TGPL did not commit itself to taking any minimum quantity of gas from participants in the MMP. R. 7927, 7958, 7962. According to TGPL, this program ultimately collapsed in late 1985. R. 9457.

TGPL, thereby denying passthrough of the $75 million surcharge claimed by TGPL. 19/

Halstead's proposed remedy allocated refunds of some $22 million, out of $36 million that TGPL had received in transportation revenues derived from its illegal sales, to TGPL's captive customers based on the extent to which each customer had been harmed by TGPL's undue discrimination. It distributed the remaining $14 million of the $36 million to all TGPL customers on a pro rata basis, as an additional "disgorgement" remedy for TGPL's filed rate and certificate violations.

In his initial decision on Phase II, the ALJ adopted the Fulton remedy, which denied TGPL the right to pass through more than the actual cost of its gas. The ALJ also rejected TGPL's argument that this remedy would deny TGPL its right under § 601 of the NGPA 20/ to pass through its purchased gas costs:

19/ Fulton also proposed a second, alternative remedy which would have denied TGPL the difference between TGPL's estimated "filed rate" of $3.01 Dth and its actual higher cost of gas during the relevant period, later determined to be approximately $3.30 Dth, for a total of $11.8 million. R. 8415.

This surcharge pertained only to the actual cost of the system supply gas delivered in the below-cost sales, and was wholly unrelated to TGPL's separate surcharge for the inflated "recorded" costs of the replacement gas. Both the ALJ and the Commission determined that TGPL was entitled to pass these costs through to its jurisdictional customers in a PGA surcharge, a ruling in TGPL's favor, which is not at issue in this appeal.

20/ Absent fraud, abuse or similar grounds, section 601 of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. § 3431, guarantees pipelines the right to pass-through the costs of gas acquired from producers.

> Fulton's remedy fully accords with section 601 . . . . The "amount paid" for the gas was the spot market price, and not the PGA's \$3.01. Far from denying passthrough, Fulton mandates it -- at the actual cost of gas.

R. 9312; 49 FERC at p. 65,165. In addition, the ALJ ordered TGPL to refund \$36 million in unlawful transportation revenues, as proposed by Halstead.

D. The Orders Of The Commission

1. The Commission's Initial Order

On September 12, 1990, the Commission issued an order affirming the ALJ's initial decisions. R. 9936. To begin with, the Commission rejected TGPL's characterization of the transactions as "transportation imbalances," rather than sales. First, it observed that while TGPL's transportation tariff required TGPL to eliminate all transportation imbalances within 30 days, and while its transportation contracts required that it make them up as soon as operationally practical, the alleged "imbalance" TGPL claimed here had lasted 13 months. R. 9944; 52 FERC at p. 61,855. Second, it noted that TGPL never advised its so-called transportation customers that the alleged imbalance existed. _Id_. At all events, the Commission reasoned that TGPL's claim that the transactions merely resulted in "imbalances" was simply not credible:

> Rather than a transportation imbalance, the transactions have all the hallmarks of a sale. The record shows that the Transco corporate family developed and operated TRI solely as a vehicle to sell Transco's system supply, as a surrogate for Transco's discount sales (DS) program, which was never permitted to become effective.

R. 9944; 52 FERC at p. 61,855.

Turning to the issue of undue discrimination, the Commission also found that the ALJ had properly relied on the MPC decisions as authority for finding undue discrimination. The Commission, like the ALJ, rejected TGPL's assertion that the prevailing industry and regulatory circumstances at the time of its actions, or the alleged benefits to its customers, justified the discrimination associated with the unauthorized sales TGPL made through its affiliates. R. 9943; 52 FERC at p. 61,854. Rather, the Commission observed that the industry and regulatory circumstances and "benefits" invoked by TGPL were virtually the same as those involved in the MPC decisions and thus did not warrant a different result. R. 9942-44; 52 FERC at pp. 61,854-55.

The Commission also generally affirmed the ALJ's choice of remedies.

2. The Commission's Orders On Rehearing

a. On rehearing, TGPL renewed its claim that the Fulton remedy denied it passthrough of its actual gas costs in violation of Section 601 of the NGPA. TGPL also objected that the Halstead remedy, requiring refunds of its transportation revenues, would improperly distribute refunds to parties that had actually benefited from the discriminatory sales.

On January 15, 1992, the Commission issued a rehearing order reaffirming the Fulton passthrough remedy. 21/ In the Commission's view, this remedy accurately reflected the actual gas costs of TRI, TEMCO, and TGPL as a single entity for the deliveries and replacement of system supply. R. 10524; 58 FERC at p. 61,050. The Commission also rejected TGPL's claim that the remedy violated the guaranteed passthrough requirement of § 601 of the NGPA, finding that it did "not provide a guaranteed mechanism for a pipeline to sell below cost and then later recover its costs." R. 10527. 58 FERC at p. 61,051. Thus, the Commission concluded that § 601 did not authorize TGPL to pass through the higher "inflated" costs recorded by TGPL, rather than the actual cost of the replacement gas. R. 10524-25.

The Commission likewise rejected TGPL's claim that its noncaptive customers, which had purchased almost all of the "cheaper" gas, suffered no harm from TGPL's recording the cost of the replacement gas at the $ 3.01 Dth "filed rate," instead of its actual cost, approximately $ 2.40 Dth. The Commission found that these customers, as well as the captives, had been forced to subsidize the below-cost sales and thus, "all those who paid $3.01 per unit for gas that cost less were harmed by Transco's actions." R. 10525 n.48; 58 FERC at p. 61,051 n.48.

21/ By the time this order had issued, TGPL had already collected $48.5 million of the $75 million, subject to refund. The Commission's orders effectively required TGPL to refund this amount plus interest, and canceled TGPL's right to collect the remaining $26.5 million ($75 million minus $48.5 million).

On the other hand, the Commission found that there were equitable considerations that warranted elimination of the Halstead transportation-revenue remedy, including the proposed allocation scheme associated with that remedy. The Commission noted that even though it had found that the relevant market and industry circumstances surrounding the transactions at issue in this case were irrelevant as a defense to TGPL's liability for NGA violations, they were entitled to some consideration in fashioning an appropriate remedy for TGPL's undue discrimination. R. 10528; 58 FERC at p. 61,052.

b. NCUC and LILCO filed for rehearing of the Commission's rehearing order. NCUC objected to the Commission's elimination of the transportation revenues remedy; LILCO protested the Commission's elimination of the Halstead allocation scheme, originally associated with that remedy, that would have refunded more than a pro rata share of refunds to parties victimized by the undue discrimination.

On March 16, 1992, the Commission issued a second order on rehearing denying both LILCO's and NCUC's rehearing requests. The Commission further explained its decision to eliminate its requirement that TGPL disgorge the transportation revenues arising from the unlawful sales as a remedy for undue discrimination:

> [a]round the time of the Transco transactions at issue here the Commission itself had authorized other pipelines to engage in special marketing programs that had discriminatory effects similar to those of Transco's transactions in this case.

> However, in the Maryland People's Counsel cases, the Court of Appeals found the Commission had not adequately justified the discrimination. Although the specific Transco transactions here do not have the veneer of Commission authorization, as those at issue in the Maryland People's Counsel cases, nonetheless, it does not appear equitable to penalize Transco further for discrimination similar to that which the Commission itself did not think was undue prior to the ruling of the Court of Appeals in the Maryland People's Counsel cases.

R. 10553-54; 58 FERC at p.61,927.

Finally, the Commission denied LILCO's request for a reallocation of the Fulton passthrough remedy according to the allocation method, proposed by Halstead, favoring captive customers. In the Commission's view "fairness and equity" required that refunds related to TGPL's gas costs should be directed to TGPL customers who overpaid such amounts. R. 10555; 52 FERC at p. 61,928. 22/

These appeals followed.

22/ The Commission also denied a claim by NCUC that the proceedings on rehearing before the Commission had been tainted by an *ex parte* request for oral argument. R. 10556 This claim is discussed, *infra*, pp. 53-57.

SUMMARY OF ARGUMENT

A.

1. There was ample evidence supporting the Commission's determination that TGPL sold jurisdictional system supply at prices below its filed rate and, in some cases, without a Section 7(c) certificate. The evidence establishes that TGPL, acting as one company with its marketing affiliates, deliberately sold system supply on the spot market and used proceeds of the illegal sales to prepay for replacement gas, which it attempted to pass through to its customers at $75 million over its actual cost.

The Commission correctly found that these transactions were sales, rather than transportation imbalances, because title to the gas flowed directly from TGPL to customers for a price, which they paid almost simultaneously. Accordingly, the Commission reasonably concluded that TGPL violated the filed-rate requirements of Section 4(d) of the Natural Gas Act by selling its gas through TRI and TEMCO at an unlawful price.

The Commission also properly concluded that TGPL unduly discriminated against its captive customers in violation of Section 4(b) of the NGA. TGPL's discriminatory programs had essentially the same features invalidated by the D.C. Circuit in _MPC I_ and _MPC II_. The market conditions and the industry and regulatory circumstances that prevailed in early 1985 were precisely the same facing the D.C. Circuit in the _MPC I_ and _MPC II_ decisions. The benefits cited by TGPL as justifying its discrimination against captive customers were virtually the same presented and found unavailing in MPC I and MPC II. Because almost all of the illegal sales through TRI and TEMCO were consummated after these D.C. Circuit decisions had been issued, the Commission fairly applied the analysis of MPC I and MPC II to find that TGPL violated Section 4(b) of the NGA.

2. In these circumstances, the Commission properly refused to permit TGPL to pass through its $75 million surcharge. This proposed passthrough arose solely from TGPL's decision to record the cost of the replacement gas at TGPL's filed rate, $3.01 Dth, instead of the actual cost of that gas, $2.40 Dth. TGPL's accounting for the replacement gas in this manner violated the NGA and Commission's PGA regulations, which allow a pipeline to recover no more than its cost of gas. The Commission's denial of passthrough was consistent with this Court's decision in Coastal Oil and Gas Corp. v. FERC, 782 F.2d 1249 (5th Cir. 1986) since it limits TGPL to recoupment of its actual gas costs in order to avoid harm to TGPL's customers.

3. The Commission also properly rejected TGPL's argument that the passthrough remedy violates Section 601 of the NGPA because, according to TGPL, it does not permit TGPL to recoup its losses from the below-cost sales. The NGPA does not grant pipeline a right to force jurisdictional customers to pay for shortfalls resulting from discounted sales of gas.

4. The evidence also establishes that the passthrough remedy was necessary to avoid harm to TGPL's customers. The replacement gas was contractually committed to TGPL, and thus

TGPL's customers would have eventually received that gas at the $2.40 price that TGPL paid for it--$75 million less than TGPL sought to charge them. In the ordinary course of events, TGPL would have made the same prepayments to its producers directly, and acquired the replacement gas at the same savings to its customers. The Commission's denial of passthrough was also proper because otherwise TGPL's customers would be forced to buy gas at TGPL's uneconomical filed rate during an off-peak period, when they were unwilling to buy gas at that price, and when they had opportunities to buy alternative supplies for substantially less.

5. TGPL's asserted benefits to customers from the below-costs sales are too uncertain and speculative. TGPL's gas costs decreased after the period of the unlawful sales, yet they should have increased during that period if the below-cost sales were having the beneficial effect claimed by TGPL. Likewise, TGPL's asserted $500 million in take-or-pay savings could have been achieved lawfully by TGPL making prepayments to producers directly, as TGPL conceded it could have done.

B.

Contrary to NCUC's arguments, the Commission explained its rationale for eliminating its $36 million transportation revenue remedy. As the Commission stated, its Enforcement Section originally proposed this only as an alternative to the passthrough remedy which the Commission ultimately adopted. The Commission also explained that the industry and regulatory circumstances during the relevant period warranted eliminating this remedy. NCUC's argument that the Commission must impose a separate remedy for each NGA violation is incorrect; the Commission possesses remedial discretion to fashion appropriate remedies and is not required to impose a remedy for every harm.

NCUC's claim that an alleged ex parte communication tainted this proceeding is also without merit. The contact at issue here involved only a request for oral argument, which only led to a procedural result -- an opportunity for all parties to ventilate their claims at oral argument before the Commission. No party was prejudiced by the request since all parties received notice and actually participated in oral argument.

C.

The Commission likewise reasonably rejected LILCO's request for reallocation of the passthrough remedy in a manner that would favor captive customers. Had the Commission ruled otherwise, the funds needed to satisfy LILCO's preferred allocation method would have come out of refunds to other TGPL customers that paid TGPL's overcharges. There was no basis for requiring noncaptive customers to pay captive customers amounts by which the latter had suffered from undue discrimination. During the period of the unlawful below-cost sales, noncaptive customers had other low-cost supply options available to them. Ordering them to give up part of their refunds would deprive them of the benefits of these foregone alternative low-cost supplies. In addition, the discrimination in this case occurred during a period when captive customers of many different pipelines, excluded from SMPs, suffered the same kind of discrimination without remedy.

ARGUMENT

I. THE COMMISSION ACTED WELL WITHIN THE SCOPE OF ITS REMEDIAL AUTHORITY IN IMPOSING A REMEDY THAT LIMITED TGPL TO A RECOVERY OF ITS ACTUAL GAS COSTS FOR ITS VIOLATIONS OF THE NATURAL GAS ACT.

A. The Commission's Determination That TGPL Violated The Natural Gas Act Is Supported By Substantial Evidence.

1.a. There is no dispute that the TGPL corporate family intentionally sold jurisdictional system supply gas to non-captive customers at prices below its filed rate. R. 2841. There is likewise ample support in the record for the Commission's determination that TGPL, TRI, and TEMCO acted as a "single-entity" for purposes of effecting these below-cost sales of system supply and the purchases of replacement gas. See 8420-22. 23/ In fact, the composition of the TGPL, TRI, and TEMCO corporate hierarchies was nearly identical. As the ALJ pointed out in his initial decision on Phase I:

> All of TRI's officers were also TGPL officers. Six of TEMCO's seven directors were also on [TGPL's] board. The board chairman and chief executive officer of TEMCO and [TGPL] were the same. With one exception, all TEMCO officers were also TGPL officers . . . . Each subsidiary had the same address as that of the pipeline.

23/ As the ALJ found, the one company approach was equally applicable to the return of the gas by TRI and TEMCO because

> [t]he purchases of the lower priced spot market gas were inextricably linked to the illegal sales. The very proceeds of the illegal sales were used to prepay for the spot market gas on a virtually simultaneous basis.

R. 9309; 49 FERC at p. 65,163.

R. 8420-21; 44 FERC at p. 65,055. See also page 16, supra.

As the ALJ carefully explained, the transactions at issue in the instant case were "sales" within the plain, everyday meaning of that term. As he correctly found, TGPL and its affiliates acted as "one company." R. 8420-21; 44 FERC at p. 65,054. They transferred TGPL's system supply for a price. R. 8420-22; 44 FERC at pp. 65,054-55. In addition, the transactions between TGPL and its noncaptive customers were complete upon delivery of the gas and payment of the purchase price, which was virtually simultaneous. R. 3373; see also 38 FERC at p. 65,157. Following delivery and payment, these customers did not owe TGPL any money or any gas. R. 3373-74. Moreover, it is uncontested that title to the system supply gas TGPL sold below-cost passed directly from TGPL to TRI's and TEMCO's customers, not through these affiliates. R. 3372. In these circumstances, the Commission properly rejected TGPL's assertion that its transactions were merely "transportation imbalances" rather than below-filed rate sales.

In the first place, transportation imbalances by their nature are usually accidental and therefore do not need Commission authorization. See R. 3290-91. In contrast, this imbalance was deliberate. R. 3269. Second, Transco's transportation tariff required elimination of imbalances in 30 days, and its transportation contracts required that they be made up as soon as was operationally practical. R. 3299. The alleged "imbalance" in this proceeding ran 13 months. R. 7838. The alleged imbalance was, moreover, extraordinary; 24/ indeed, TGPL's own witness, H.J. Miller admitted that it was the largest he had seen with the company or in the industry. R. 3316. 25/

Furthermore, and of particular significance, TGPL's "transportation customers" would have been financially accountable for and thus entitled to know about imbalances. Yet, TGPL never informed them that the imbalances even existed. R. 3298. 26/

Thus, the evidence completely refutes TGPL's attempt to brush off its patently illegal sales activity under the rubric of "transportation imbalances." In sum, the Commission correctly

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24/ Furthermore, the replacement gas, which was eventually used to correct the "imbalances," had not even been produced at the time that the alleged imbalances were allowed to grow, and Miller testified that never before had TGPL experienced "imbalances" associated with gas that had not yet been produced. R. 3321.

25/ Miller conceded that the imbalances lasted longer than normal imbalances, R. 3317, were unusual in scope and dimension and size, and exceeded anything he had ever seen before. R. 3301, 3315, 3317. Mr. Miller added that the gas subject to the alleged imbalances accounted for over half of TGPL's system supply during a period when TGPL was overstocked with excess deliverability. R. 3321.

26/ TGPL's claim (TGPL Br. 16) that the first ALJ who heard this case found that substantial evidence supported a determination that the transactions involved here were transportation imbalances, as opposed to sales, is misleading. That ALJ clearly left the question whether the transactions were sales or imbalances for the Commission to decide. 38 FERC at p. 65,164. A careful reading of the ALJ's language reveals that the ALJ's comment about substantial evidence dealt only with TGPL's Account No. 191 balances, *i.e.*, the cost support for TGPL's proposed pass-through--in the event that the Commission ultimately determined the transactions were determined to be transportation imbalances, and not sales. *Id*.

determined that "sales" involved here were not "transportation imbalances." See also United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1985)(ruling that a transaction is a jurisdictional sale if its economic effect is similar to that of a sale and if failure to designate the transaction as a sale would permit circumvention of the Act).

b. Nor, as petitioner claims (TGPL Br. 41-48), does the Commission's decision in Granite State Transmission Inc., 47 FERC ¶ 61,429 (1989) support a contrary conclusion. The imbalances involved in Granite State were a far cry from the thinly disguised sales of system supply at issue here. In Granite State, two different types of imbalances had actually developed. One type of imbalance involved deliveries of spot market supplies to Granite State, as purchaser, by Tennessee Gas Pipe Line Company ("Tennessee"), as transporter. Tennessee, in turn, had operating difficulties that caused it to under-deliver volumes destined for Granite State. The second type of imbalance resulted from Granite State's deliberate overpurchase of gas supplies from an entirely different source, Shell Canada Ltd., and Granite State's reliance on these excess supplies in its own pipeline to serve as a substitute for acquiring storage facilities to meet unanticipated needs and avoid imbalance penalties. The Commission recognized these situations as imbalances, but refused to allow costs to be passed through to Granite State's customers until the imbalances were corrected, i.e., until Granite State's customers actually received delivery of the gas.

The so-called imbalances in this case resemble neither of the imbalances recognized in Granite State. Here, TGPL actually delivered gas and received payment in full from its customers, and thus no imbalance between TGPL and its customers was ever created. In contrast, in Granite State, no gas was delivered to, and no payment was received from, Granite State's customers during the period of imbalances. Moreover, in this case, unlike Granite State, the accounting issues did not relate to any operating difficulties of a transporter, or the storage needs of a pipeline, but arise from a deliberate scheme by TGPL to increase its sales of system supply gas and its transportation revenues, and an attempt to force its on-system customers to subsidize its below-cost sales.

Finally, as the Commission correctly recognized, in Granite State, there was no finding that the pipeline delivered gas to its customers in violation of its filed rate, and there were no violations of "certificate" authorization through deliveries of system supply to off-system customers. Moreover, no Granite State customer was forced to subsidize the imbalances at issue. R. 10517, 58 FERC at p. 61,047.

2. Likewise well-founded are the conclusions reached both by the ALJ and the Commission that TGPL's below-cost sales were unduly discriminatory and that TGPL had not carried its burden of justifying its discrimination against captive customers. As the

evidence showed, TGPL proceeded with its discriminatory programs with full knowledge of the D.C. Circuit's serious doubts, expressed in MPC I and MPC II, about the legality of discrimination against captive customers. 27/ The market conditions and the industry circumstances at the time of TGPL's sales were the same that existed at the time of the MPC I and MPC II decisions. The benefits cited by TGPL--reduction in take-or-pay liability and overall cheaper gas--were the same presented and found unavailing by the D.C. Circuit in those decisions.

The Commission therefore fairly applied the same "undue discrimination" analysis performed by the D.C. Circuit in MPC I and MPC II to the transactions at issue. Because TGPL had failed to show that the alleged benefits to captive customers flowing from these transactions could not have been achieved through less discriminatory means, the Commission reasonably determined that TGPL violated NGA § 4(b) by unduly discriminating against its captive customers. R. 7963. 28/

27/ Even though a small number of TRI below-cost transactions may have predated the MPC I and MPC II decisions, TGPL and its corporate parent made a conscious decision to proceed with these transactions in full force even after the decisions were issued. See R. 3270, 7824. And all of the illegal sales through TEMCO were consummated after those decisions.

28/ TGPL's violations of Section 7(c) of the NGA are not at issue in this appeal. TGPL does not dispute that some of its system supply was sold to customers off its system without Commission authorization to sell gas, in violation of Section 7(c) of the NGA. See TGPL Br. 12 n.10. As TGPL acknowledges, it "has not challenged this aspect of the Commission's order." Id.

B. <u>The Commission's Pass-Through Remedy, Limiting TGPL To Its Actual Cost Of Service, Is Well Within The Commission's Statutory Authority</u>

The Commission's refusal to permit pass-through of TGPL's surcharge was also proper. There is no dispute that TGPL charged its customers $3.01 per Dth for gas that cost its affiliates considerably less. As previously shown, see note 14, supra, TGPL, through TRI and TEMCO, paid an average of $2.55 and $2.23 per Dth, respectively, or an average of roughly $2.40 per Dth, for the replacement gas. Moreover, it is undisputed that when TRI and TEMCO returned this gas at no cost to TGPL, TGPL then sought to recover the equivalent of its filed rate, $3.01 per Dth, for this gas from its jurisdictional customers through its PGA account. It is likewise uncontested that TGPL's proposed passthrough arose solely because of the difference between the inflated "recorded" cost of the replacement gas and its actual cost. In these circumstances, the Commission was amply justified in denying TGPL's passthrough to the actual cost of its gas.

Indeed, the NGA and Commission regulations require no less. The NGA, case law, and the Commission's PGA regulations are based on the cost of service methodology. See City of Detroit v. FPC, 230 F.2d 810 (1955), cert. denied, 352 U.S. 829 (1956); cf. Farmers Union Central Exchange v. FERC, 734 F.2d 1486, 1503 (D.C. Cir. 1984), cert. denied, 469 U.S. 1034 (1984). Section 4(e) of the NGA and the Commission's PGA regulations require the refund of rates that are not just and reasonable where, as here, they were collected subject to refund. See note 3, supra. Indeed, the Commission's PGA regulations have always specified that natural gas companies may recover no more than their cost of gas. See 18 CFR § 154.38(d)(4); see Locust Ridge Gas Co., 34 FERC ¶ 61,311 (1986); rehearing denied, 35 FERC ¶ 61,215 (1986) (holding that the filed rate doctrine precludes pipelines, which deliberately sell gas below their filed rate, from collecting any ensuing underrecovery of costs through subsequent PGA surcharges). TGPL's actions in this case contravened all of these provisions. Therefore, the Commission was justified in invoking the full panoply of its statutory authority, including the "necessary or appropriate" clause of Section 16 of the NGA, 15 U.S.C. § 717o, to limit TGPL's passthrough to the actual cost of the replacement gas. Ecee, Inc., v. FERC, 645 F.2d 339, 353 (5th Cir. 1981); Mesa Petroleum Co. v. FPC, 441 F.2d 182, 189 (5th Cir. 1971).

By recording an inflated cost for the replacement gas, TGPL effectively surcharged its jurisdictional customers for a deficiency in revenues resulting from previous sales of underpriced gas, a practice prohibited under Locust Ridge, supra. 29/

29/ Although the ALJ found that the Locust Ridge principles did not afford a basis for denying passthrough of TGPL's actual gas costs, see R. 9305; 49 FERC at p. 65,162, this discussion was confined to the separate lawful surcharge for the actual cost of the gas delivered in the below-cost sales ($11.8 million), and not the surcharge at issue here related to the replacement gas. See note 19, supra.

C. The Commission's Remedy Is Consistent With This Court's Decision In Coastal.

Finally, contrary to TGPL's claim (TGPL Br. 24), the Commission's denial-of-passthrough remedy does not run afoul of this Court's decision in Coastal Oil and Gas Corp. v. FERC, 782 F.2d 1249 (5th Cir. 1986)("Coastal") or any other precedent dealing with the Commission's remedial authority. In Coastal, this Court ruled that the Commission lacked authority under the NGA to impose a remedy that "penalizes" a pipeline for unlawful action. As this Court explained in that case, part of the refund the Commission imposed there was tantamount to a penalty because it exceeded the injury to the pipeline's interstate customers and denied the pipeline "any payment whatsoever for the gas including recoupment of costs", id. at 1213 (emphasis added). The Commission's action in this case presents exactly the opposite situation since it limits TGPL to recoupment of its actual gas costs in order to avoid harm to TGPL's customers. 30/ The Commission's remedy therefore fully comports with the principles this Court articulated in Coastal.

D. TGPL's Remaining Contentions On This Point Have No Merit.

TGPL raises a variety of claims challenging the Commission's findings in this case. As explained below, none has substance.

30/ TGPL argues (TGPL Br. 28) that the Commission's passthrough remedy is improper because, according to TGPL, it did not profit from the illegal sales. However, it was the harm to TGPL's customers, not TGPL's enrichment, that was the focus of the Commission's remedy.

1. **<u>TGPL's Claim That The Commission's Remedy Violates The "Guaranteed Passthrough" Requirements Of Section 601 Of The NGPA Is Without Substance.</u>**

TGPL claims (TGPL Br. 42-43) that the Commission's remedy violates Section 601 of the NGPA, which guarantees pipelines recovery of their actual gas costs, because, according to TGPL, the remedy denies recovery of TGPL's gas costs. The Commission properly rejected this claim. 31/ Since the Commission's remedy allows TGPL to recover its actual gas costs, both for the gas it illegally sold and for the gas it purchased to replace it, the remedy fully comports with Section 601. (Tr. 2230)

Indeed, TGPL does not dispute the Commission's finding that its remedy permits TGPL to include all of its or its affiliates' actual gas costs in its PGA to the extent those costs relate to both the illegally sold and replacement gas. See TGPL Br. at 42-43. Rather, TGPL's main objection is that the Commission's analysis of the proper remedy does not take into account TGPL's revenues, i.e., losses from the below-cost sales, and is flawed because TGPL has sustained a shortfall of $75 million when its gas costs are compared to its revenues from its below-cost sales. These arguments are unavailing.

31/ Although TGPL (TGPL Br. at 42) cites passages from the initial decisions recognizing that the NGPA does not permit the Commission to deny recovery of actual gas costs even when gas subsequently is put to an improper use, this discussion pertained only to whether TGPL should be denied recovery of an additional $11.8 million based solely on its underestimation of its actual gas costs. As noted, see note 19, supra, the Commission allowed TGPL to recover these costs, and this issue is no longer relevant to this case.

Section 601 of the NGPA confers upon pipelines a right to pass through their gas costs incurred through arms-length dealings with producers; but nothing in § 601 of the NGPA or its legislative history addresses the unusual event in which, as here, a pipeline deliberately chooses not to exercise the right to sell the gas at its cost. Similarly, nothing in § 601 suggests that it was intended to serve as a vehicle by which pipelines could force their customers into subsidizing below-cost sales. In short, the Commission's determination that Section 601 of the NGPA does not grant pipelines a right to force customers to pay for shortfalls resulting from below-cost sales was clearly reasonable, and therefore is entitled to deference. See Office of Consumers' Counsel v. FERC, 783 F.2d 206, 218 (D.C. Cir. 1986).

In this regard, the Commission's interpretation of § 601 is also supported by the testimony of TGPL's own witness, Jack Kaminsky. Mr. Kaminsky conceded that the Commission's PGA regulations allow only the inclusion of costs, and not the effect of revenues, in calculating a pipeline's Account No. 191 balance. See R. 2021, 2153. Mr. Kaminsky further explained that, under the Commission's PGA regulations, if TGPL sold its gas below its filed rate it would not be entitled to recover the difference between the filed rate and the lower price it received for that gas. R. 2153, 2156, 2191-95. See also Locust Ridge Gas Co., 34 FERC ¶ 61,311 (1986); rehearing denied, 35 FERC ¶ 61,215 (1986). The Commission therefore correctly declined to consider the revenues resulting from TGPL's below-cost sales. See 10524-25, 10527.

2. TGPL's Claim That The Commission Has Not Shown That Its Customers Were Harmed By Its Above-Cost Surcharges Is Without Merit.

a. TGPL's suggestion (TGPL Br. 28-37) that the Commission's passthrough remedy is improper because customers on its system-- captive and noncaptives--were not harmed and actually benefited from its unlawful actions is entirely unsupported.

TGPL suggests (TGPL Br. 27-33) that the Commission's remedy is inequitable because its customers would not be unfairly harmed by the $75 million passthrough. In its words "the transactions . . . [were] wash for the sales customers" since 'gas is a fungible commodity' . . . molecules are traded for molecules': WACOG out, WACOG in." (Br. 15). On the other hand TGPL's argues that, as a result of the Commission's remedy, TGPL will unfairly be forced to underrecover $75 million it spent for gas during the period at issue here (TGPL Br. 23, 43). These claims have no merit.

TGPL's assertions overlook a critical fact about the replacement gas sold to TGPL's customers at the inflated recorded cost: TGPL's customers would have eventually received that gas at the roughly $2.40 price that TGPL paid for it, regardless of whether TGPL ever made the illegal below-cost sales. Significantly, TGPL was under a contractual obligation to purchase the so-called replacement gas that it bought from its producers. While TGPL's contracts obligated it to pay $13-$14 per Dth for that gas, no pipeline was buying gas at those levels. Instead, such high-cost contracts were being renegotiated as pipelines sought to minimize their potential liability for imprudent gas purchasing practices.

That is what happened here. TGPL renegotiated these contracts and purchased this gas at an average of $2.40 Dth. TGPL's customers were owed the benefit of these price reductions. 32/ Instead of passing this low cost through to them, TGPL attempted to overstate the cost of this gas by $75 million. TGPL's actions therefore deprived its customers of the benefit of the low cost, to which they would have been entitled absent TGPL's illegal activity. The Commission properly refused to countenance such action and imposed a remedy which returned the parties to the position they would have occupied absent TGPL's illegal activity.

The Commission likewise properly refused to permit TGPL to force its on-system customers to pay more than the cost of the replacement gas to offset TGPL's below-cost sales through TRI and TEMCO. TGPL's failure to collect revenues sufficient to recover the actual cost of the gas sold through TRI and TEMCO was solely the result of its own deliberate decision to price its gas $75 million below its filed rate. If the Commission had subsequently required TGPL's customers to pay for this revenue deficiency--as

32/ TGPL's President admitted that TGPL could have made the same prepayments to the same high-cost gas producers directly, and thereby achieved the same take-or-pay savings without selling gas below cost. R. 2823. In addition, the record establishes that after TGPL terminated its below-cost sales program, its average purchased gas costs steadily declined from roughly $3.30 to $2.09 per Dth by May 1986. R. 7839.

TGPL contends it should have--the customers would have been forced against their will into the same financial position they would have occupied had they purchased the quantities through TEMCO and TRI at TGPL's filed rate. Given the supply and demand conditions from April through November 1985, however, these customers had no interest in, and could readily have avoided, purchasing that gas at the filed rate during April-November 1985. 33/ Manifestly, TGPL's customers should not be forced to pay a price -- the additional $75 million surcharge--that they could have avoided when they made their gas purchases.

b. Nor is there any merit to TGPL's claim that its customers--both captives and non-captives--actually benefited from these transactions because some of the gas TGPL offered in its below-cost sales was purchased by the same on-system customers who are subject to TGPL's surcharge. In the first place, TGPL's captive customers were not permitted to buy <u>any</u> of

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33/ This was a period of warmer weather, normally an off-peak, low demand period for pipeline sales. TGPL's witness, H.J. Miller, testified that there was no market for the quantities sold through TRI and TEMCO at TGPL's filed rate. R. 7826-27.

the lower-priced TEMCO gas, 34/ and were permitted to purchase only a tiny fraction of the TRI supplies. 35/

TGPL's noncaptive customers likewise received no benefits from the lower-priced TEMCO supplies because they had opportunities to achieve savings from alternative suppliers that were almost as valuable as the discounts they received from TEMCO. See R. 2634. 36/ Likewise, noncaptive customers who purchased from TRI did not significantly benefit from TGPL's below-cost sales service. These customers had other supply options as well. See R. 2480-81, 3275, 3279.

In sum, TGPL's claim that its captive and non-captive customers benefited from its below-cost sales is patently spurious.

34/ TEMCO gas, which accounted for roughly half of TGPL's below-cost system supply volumes, was offered to TGPL's customers only on a "sales nondisplacement basis," which meant that TGPL would refuse to transport this gas on behalf of any customer whose purchase of TEMCO gas would displace a purchase of TGPL system supply at its regular filed rate. R. 3991. Captive customers, whose purchase from TEMCO would displace a purchase of TGPL system supply, were thus barred from purchasing low-cost TEMCO gas because of this policy.

35/ Captive customers of TGPL were permitted to buy only 3% of their contract entitlement, and, in fact, they purchased only 0.38% of TRI volumes above this 3% level, due to restrictive conditions imposed upon them by TGPL's threshold levels program.

36/ TGPL's own witness, H.J. Miller, conceded that the difference between making a sale and not making a sale in the competitive markets served by TEMCO was no more than a penny per Dth. See R. 372, 10065.

3. <u>**TGPL's Claim That The Commission Failed To Take Into Account Other Alleged Benefits To Customers Flowing From The Below-Cost Sales Must Also Be Rejected.**</u>

TGPL next claims (TGPL Br. 37-39) that it presented evidence of other "significant benefits" to TGPL's customers from the illegal sales and complains that these asserted benefits were ignored by the Commission. For example, TGPL asserts (TGPL Br. 17 n.17) that the TRI's and TEMCO's prepayments to Shell Oil and other high cost gas producers during the summer of 1985 enabled TGPL to avoid $500 million in take-or-pay liability. TGPL also asserts (<u>id.</u>) that the higher volumes taken from producers by TGPL and its affiliates saved its customers $36 million because TGPL would otherwise have had in its mix a higher percentage of expensive "must-take" gas, <u>i.e.</u>, gas that the pipeline had to take to avoid take-or-pay liability. <u>37/</u> In both its order affirming the initial decisions and its first rehearing order, the Commission properly considered and rejected these allegations, finding that the ALJ had adequately answered them in his initial decisions. The Commission's rulings were correct.

As the ALJ explained, TGPL's alleged benefits were too uncertain and speculative. In his initial decision (Phase I), the ALJ observed that after November 1985, when TGPL's below-cost sales ceased the pipelines's system gas costs went <u>down</u>, not up, as would be expected if TGPL's illegal sales activities were

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<u>37/</u> TGPL also asserts (TGPL Br. 17 n.17) benefits in the form of $53 million in savings to its customers as a result of prepaying its producers for gas through TRI and TEMCO. We have already answered this claim, <u>supra</u>, p. 42-44.

having the "cost savings" effect claimed by TGPL. R. 3115, 8425. In addition, TGPL's witness acknowledged that TGPL was able to successfully renegotiate high cost gas contracts after the illegal sales activity ceased. R. 3115.

Moreover, as the ALJ also observed, the so-called benefits arising from the below-cost sales were likely canceled out by the later return of the gas. Although TGPL's gas costs declined after the sales had ended, the ALJ correctly reasoned that TGPL had failed to show that whatever "benefits" were achieved during the period of the illegal sales were not canceled out by later returns of gas. R. 8425. As he explained:

> If the subsidiaries' sales of TGPL system gas originally freed the pipeline to stock up on cheaper gas, their subsequent return of gas should then have prevented the pipeline from later buying cheaper gas. The company made no effort to demonstrate that the former "savings" exceeded the latter "losses."

Id. 44 FERC at p. 65,057. 38/

The ALJ also found that the TGPL had not shown that its illegal sales scheme conferred any benefits that could not have been achieved legally. R. 8425. Thus, although TGPL's president, David J. Mackie, asserted that TGPL saved $500 million in take-or-pay liability by its affiliates' prepayments, he nonetheless admitted that TGPL could have made its prepayments

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38/ TGPL's witness, Miller, conceded that during the 1985-1986 winter heating season (when gas costs were declining) TGPL's gas purchases were reduced below a level which it would otherwise have maintained but for its receipt of the replacement gas over a five-month period ending in April 1986. R. 3114-16.

directly to Shell Oil and other high-cost gas producers for additional supplies of gas, without going through affiliates, and thereby achieved the same take-or-pay savings without engaging in its elaborate sale-and-repurchase scheme. R. 2823. Indeed, the corporate family would have had more money available to make the prepayments because it would not have been buying gas (at around \$3.30 Dth) and then selling it at a loss (at an average of \$2.40 Dth), as it did here in order to market its system supply gas through TRI and TEMCO. 39/

4. TGPL's Other Objections To The Commission's Denial-Of-Passthrough Remedy Are Groundless.

a. TGPL also claims (TGPL Br. 32) that this case "is not about remedying TGPL's violations of the PGA procedures" because, according to TGPL, the ALJ and the Commission found that TGPL "properly calculated its PGA during the time periods relevant to this case." This claim, too, is erroneous. Neither the Commission nor the ALJ ever found that TGPL calculated its PGA balances correctly with respect to the actual cost of the

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39/ TGPL complains (TGPL Br. 37-39) that the Commission improperly shifted the burden of proof on remedies to TGPL by requiring TGPL to show that it could not have achieved the these asserted benefits through other means. In fact, the Commission's Enforcement Section carried its burden of proof, see pages 14-15, 23, supra, by showing that TGPL's customers were harmed by being charged \$3.01 per Dth for gas that cost approximately \$2.40 Dth.

At that point, the burden of producing evidence shifted to TGPL to demonstrate that its alleged benefits outweighed the harm caused by its overcharges associated with the return gas. It failed to satisfy this burden because, as shown above, its evidence of "benefits" was ambiguous and inconclusive. R. 9312-13.

replacement gas. Just to the contrary, the ALJ and the Commission both ruled that TGPL improperly calculated its purchased gas costs by including the inflated "estimated" $3.01 Dth cost of the replacement gas, instead of the lower actual costs, in its PGA. See R. 9312; 49 FERC at p. 65,164-65. 40/

b. TGPL also implies (TGPL Br. 6-7) that the Commission is to blame for TGPL's actions in this case, because of the Commission's elimination of minimum commodity bills and its failure to alleviate the take-or-pay problems facing pipelines in the mid-1980s. But unresolved status of take-or-pay issues was no excuse for TGPL's decision to take the law into its own hands, and to engage in self-help outside the NGA. As we have explained earlier, (supra, at pages 7-8, 42-43) TGPL had other--legitimate--ways to reduce its take-or-pay liability. In any event, as the Supreme Court has recognized in the take-or-pay context:

> [A]n agency need not solve every problem before it in the same

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40/ TGPL's assertion that the Commission and the ALJ both found that TGPL properly calculated its PGA relates to the entirely separate question whether TGPL should be denied recovery of some additional $11.8 million in actual gas costs because TGPL underestimated those costs during the period of the illegal sales. See 49 FERC at p. 65,161-62; 58 FERC at p. 61,050, n.44. See also note 19, supra. The first part of Mr. Fulton's proposed remedy, which has not adopted by either the ALJ or the Commission, would have denied TGPL the right to recover the $ 11.8 million, the difference between the filed rate of $ 3.01 Dth that was in effect from April through September 1985 and its higher actual cost during that period.

This matter has no bearing here because the Commission ruled that, by virtue of § 601 of the NGPA, TGPL could not be denied passthrough of the $ 11.8 million, a ruling in TGPL's favor that no other party has appealed.

> proceeding. This applies even where the initial solution to one problem has adverse consequences for another area that the agency was addressing.

Mobil Oil Exploration & Producing Southeast v. United Distribution Companies, 111 S. Ct. 615, 627 (1991). See also Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, 435 U.S. 519, 543-44 (1978).

II. THE CLAIMS OF THE REMAINING PETITIONERS -- BASICALLY MAKING THE ASSERTION THAT THE REMEDY FASHIONED BY THE COMMISSION WAS INSUFFICIENT -- ARE WITHOUT MERIT

A. NCUC Errs In Its Claim That The Commission's Remedy Was Inadequate In The Circumstances Of This Case.

1. NCUC initially argues that the Commission's reasons for eliminating this additional remedy were insufficiently vague and unfocused. (NCUC Br. 14) NCUC also suggests that it was improper for the Commission to have taken into account the relevant market and industry circumstances in its consideration of remedies. (NCUC Br. 20.)

The Commission's reasoning for eliminating this remedy was two-fold. First, the Commission's Enforcement Section proposed the remedy as a stand-alone alternative to the $75 million gas cost remedy, to be adopted in the event the Commission declined to impose the gas cost remedy. Since the Enforcement Section had not proposed both remedies, the Commission took this factor into account when it reconsidered the remedy and eliminated it. Second, the Commission properly assessed the relevant market and industry circumstances surrounding TGPL's discriminatory practices. As the Commission recognized in its March 16, 1992 order, this case followed closely on the heels of several SMPs containing similar features that were approved by the Commission on an experimental basis. Accordingly, the Commission reasonably concluded that

> it does not appear to be equitable to penalize Transco further for discrimination similar to that which the Commission itself did not think was undue prior to the ruling of the court of appeals in the Maryland People's Counsel cases.

R. 10554; 58 FERC at p. 61,927. Second, even though TGPL embarked upon its program at a time when the D.C. Circuit had already cast serious doubt on the legality of SMPs, the Court had not declared this type of discrimination illegal *per se*, and, in the *Maryland Peoples Counsel* v. *FERC*, 768 F.2d 450 (D.C. Cir. 1985)(*MPC III*), issued on August 6, 1985, it allowed the experimental program to die a natural death more than two months later on the Commission's preestablished "sunset date," October 31, 1985, rather than invalidate the program immediately. 41/

2. NCUC also claims that the Commission was fully aware of these circumstances when it affirmed the transportation-revenue remedy in its September 12, 1990 order, and that it offered no new rationale to explain its change in position. (NCUC Br. 14, 26.) NCUC overlooks the fact, however, that the Commission allowed the parties an additional round of supplemental briefing and also heard extensive oral argument on the question of

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41/ Thus, during this time period, captive customers of all pipelines with SMPs had been routinely experiencing this form of discrimination, without apparent remedy.

remedies. The purpose of the statutory rehearing procedure under the NGA is to give the Commission an opportunity to take a fresh look at the issues presented or overlooked in its prior order, as well as any new issues raised by that order; and, as noted at p. 23-25, supra, the Commission has fully explained its reasoning for its change in position in its order on rehearing. 42/

3. Finally, NCUC claims that when the Commission finds statutory violations causing injury to natural gas consumers, the Commission has an affirmative duty to impose a remedy for each violation. (NCUC Br. 22). There is no merit to this claim. This argument was raised and rejected recently by the D.C. Circuit in Towns of Concord, Norwood & Wellesley v. FERC, 955 F.2d 67, 72-73 (D.C. Cir. 1992), decided under the parallel provisions of the Federal Power Act. As that Court explained:

> Invoking ubi jus, ubi remedium--for every right a remedy--the Towns argue that the Commission is deprived of remedial discretion . . . . This is good advocacy but the case cannot be decided on any such theory. . . . The Towns possess only the 'rights' the Federal Power Act confers, no more, no less . . . . The Federal Power Act does not explicitly deprive the Commission of remedial discretion with respect to refunds; in fact, the Act quite clearly confers it.

42/ NCUC's assertion (NCUC Br. 17) that there is no support for the Commission's finding that its gas cost remedy already included a remedy for undue discrimination is also insubstantial. Just to the contrary, the gas cost remedy eliminates the major harm associated with the undue discrimination against captive customers, i.e., TGPL's attempt to require captive customers to cross-subsidize the below-cost sales to its favored customers.

955 F.2d at 73. 43/

In this context, NCUC's reliance on Atlantic Refining Co. v. Public Service Commission, 360 U.S. 378 (1959) (CATCO), is misplaced. CATCO was not concerned with the scope of the Commission's remedial discretion. Instead, the focus in CATCO was on the insufficiency of the evidence supporting a Federal Power Commission finding of public convenience and necessity relating to that Commission's issuance of permanent certificates under NGA § 7(c). Public Service Commission v. FPC, 543 F.2d 757 (D.C. Cir. 1974), on which NCUC also relies, likewise does not support its position. In that case, the court simply ruled that the Federal Power Commission had applied the wrong criteria in measuring the amount, and in determining the timing of, producer refunds. 44/

B. NCUC's Additional Claim That An Alleged Ex Parte Communication Tainted This Case Is Without Merit.

1. Following a non-public investigation by the Commission's Chief ALJ into allegations of an ex parte

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43/ In Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577 (1980), the Supreme Court stated principles decided under the Federal Power Act are equally applicable to the Natural Gas Act because "the relevant provisions of the two statutes 'are in all material respects substantially identical' . . . . [W]e therefore follow our established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes."

44/ Gulf Oil Corp. v. FERC, 706 F.2d 444 (3d Cir. 1983), on which NCUC also relies (NCUC Br. 22), has no bearing here. As NCUC concedes (NCUC Br. 22), the court in Gulf Oil was concerned only with the evidentiary support for the Commission's computation of a refund.

communication arising out of TGPL's request for oral argument, the Commission, in its initial rehearing order, stated:

> While the Commission's rules governing _ex parte_ communications do not apply to procedural communications that are unrelated to the merits of a case, "this is the kind of doubtful situation that should be treated as involving comments relating to the merits in order to protect the integrity of the decisionmaking process." In such cases, the agency should treat the communication as _ex parte_ and make the matter public. At the same time, assuming this to have been an _ex parte_ communication, we find no harm was occasioned by it. No party requested rehearing of our order setting oral argument; and all parties were permitted to argue. Thus, we find the integrity of the decisionmaking process was not adversely affected by the previously undisclosed oral request for an oral argument.

R. 10532-33; 58 FERC at p. 61,054. 45/ NCUC filed a request for rehearing alleging that the existence of the request required the Commission to reinstate the $36 million transportation-revenue remedy that it had eliminated on rehearing. On March 16, 1992, without further discussion, the Commission denied NCUC's subsequent request for rehearing of this ruling.

2. In its brief to this Court, NCUC reasserts (NCUC Br. 28) that TGPL's request for oral argument was an _ex parte_ communication prohibited by section 5 U.S.C. § 557(d). NCUC challenges the Commission's ruling that no harm flowed from the _ex parte_ request, stating that oral argument before the

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45/ Chairman Allday and Commissioner Terzic jointly filed a separate statement dissenting in part. In their view, the request for oral argument was procedural in nature, not a communication relative to the merits of the proceeding, and therefore, it was not an "_ex parte_ communication" within the meaning and prohibition of the Administrative Procedure Act. R. 10532-33. 58 FERC at p.61,054.

Commission is unusual, and the Commission eliminated the transportation-revenue remedy on rehearing--following oral argument.

As the Commission explained, however, regardless whether the communication should be treated as ex parte, it did not in any way taint the Commission's decisionmaking process. 46/ This ruling was clearly correct. To have a tainting effect, the ex parte contact must "be of a fundamental nature," Amos Treat & Co. v. SEC, 306 F.2d 260, 262 (D.C. Cir. 1962), and must "seriously infect the proceedings," Pillsbury Company v. Federal Trade Commission, 354 F.2d 952, 954 (5th Cir. 1966); accord, California v. FERC, 9th Cir. No. 90-70203, slip op. at 3577 (decided April 3, 1992); American Public Gas Ass'n v. Federal Power Commission, 567 F.2d 1016, 1070 (D.C. Cir. 1977). Moreover, in resolving the issue whether communications to a quasi-judicial body are improper, "one must look to the nature of the communications and particularly to whether they contain factual matter or other information outside of the record, which the parties did not have an opportunity to rebut." Power Authority of the State of New York v. FERC (PASNY), 743 F.2d 93, 110 (2d Cir. 1984) (citing

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46/ Contrary to NCUC's suggestion (NCUC Br. 15, 29), a majority of Commissioners did not find that the request for oral argument was a prohibited ex parte communication. Rather, choosing to treat the request as "one of those doubtful situations," the majority gave all the parties the benefit of the doubt, conducted an investigation, disclosed the fact of the communication on the public record, and unequivocally found no harm flowed therefrom.

PATCO v. FLRA, 672 F.2d 109, 112-113 (D.C. Cir. 1978)); United States Lines v. FMC, 584 F.2d 519, 533-534 (D.C. Cir. 1978).

Such an examination here indicates that the Commission's decisional processes were in no way tainted. No undisclosed "evidence" was introduced by the request for oral argument; rather, at most, the request only led to a procedural result -- an opportunity to all parties to ventilate their claims at the oral argument the Commission scheduled. As the D.C. Circuit recently pointed out in Louisiana Association of Independent Producers, supra, none of the evils associated with ex parte contracts from merely affording procedures to ventilate the parties' claims since they are not tantamount to "[s]urreptitious efforts to influence an official charged with the duty of deciding contested issues upon an open record in accord with basic principles of our jurisprudence" quoting WKAT, Inc. v. FCC, 296 F.2d 375, 383 (D.C. Cir. 1961), cert. denied, 368 U.S. 841 (1961). As that Court went on to explain (id. at 18-19):

> The Administrative Procedure Act bars ex parte communications only if they are "relevant to the merits of the proceeding." U.S.C. § 557(d)(1)(A). Other communications, including inquiries into the procedural status of the case or general background discussions, are not prohibited. See, e.g., Professional Air Traffic Controllers Org. v. FLRA, 685 F.2d 547, 563 (D.C. Cir. 1982).

In this case, all parties received notice and participated in the oral argument, and, as noted, no party protested or sought rehearing the Commission's decision to hold oral argument. Moreover the Commission conducted an investigation and disclosed the fact of the communication on the public record, thereby "maintaining the integrity of the process and curing any possible prejudice that the contacts may have caused." Louisiana Association of Independent Producer, supra at 19 (citing 5 U.S.C. § 557(d)(1)(C) & (D), PATCO v. FLRA, 685 F.2d 565 & n.36, Sierra Club v. Costa, 657 F.2d 298 398-399 (D.C. Cir. 1981)).

In sum, regardless of whether the communication at issue here is "treated" as an ex parte communication, it is clear that, as all the Commissioners in this case have agreed, it did not adversely affect the integrity of the Commission decisionmaking process. Thus, as the presumption of honesty and integrity accorded agency officials stands unrebutted, see Withrow v. Larkin, 421 U.S. 35, 43 (1975), the Commission's finding that there was no harm occasioned by the oral request for oral argument should not be disturbed.

C. LILCO's Arguments As To Remedy Also Lack Merit

LILCO contends that the Commission abused its discretion when it decided not to retain the allocation scheme previously associated with the transportation-revenue remedy, and apply it instead to the $75 million passthrough remedy. LILCO requested on rehearing that the Commission deduct from the gas cost remedy $22 million with interest, the same amount previously allocated to victims of TGPL's discriminatory sales practices under the transportation-revenue remedy, to make captive customers whole. Under LILCO's request, the remainder of the gas cost remedy would be distributed on a pro rata basis to all TGPL customers victimized by TGPL's gas overcharges, only after the captive customers had been compensated for undue discrimination. The Commission denied this request in its March 16, 1992 order, explaining that the refunds should be made to the customers who paid the gas overcharges.

1. The Commission's Refusal To Adopt LILCO's Allocation Scheme Was Reasonable

LILCO argues that the Commission's decision not to adopt LILCO's proposed allocation scheme was not supported by reasoned decisionmaking. (LILCO Br. 25-26). The Commission, however, fully set forth its reasoning for denying LILCO's rehearing request. The funds needed to satisfy LILCO's allocation method would have to come out of refunds to other TGPL customers, and, as the Commission explained, "fairness and equity require that the surcharge amounts already collected . . . be refunded to the Transco customers who paid such amounts." R. 10555; 58 FERC at p. 61,928. The Commission added that "customers who paid the surcharge are entitled to a refund of amounts paid." Id.

This approach was eminently fair and reasonable. As noted, all of TGPL's so-called favored noncaptive customers, which received TGPL system supply at below-cost prices through TRI and TEMCO, were led to believe that they were receiving released gas or other spot market supplies; none was aware that what it was receiving was actually TGPL system supply. Moreover, as noted, most, if not all of TGPL's "favored" customers had other low-cost supply options available to them. Therefore, because ordering these customers to give up part of their refunds to TGPL's captive customers would have deprived them of the benefits of competitive alternatives they lost by choosing supplies from TRI and TEMCO, LILCO's proposed remedy would have been inequitable.

2. <u>The Commission's Allocation Scheme Does Not Perpetuate Undue Discrimination</u>

LILCO also argues that the Commission's allocation scheme is flawed because it perpetuates the undue discrimination TGPL inflicted on its captive customers (LILCO Br. 19). Our discussion of the Commission's reasoning about the relevant market and industry circumstances and its approval of various SMPs, see pp. 50-51, supra, is equally applicable here. As noted, the discrimination in this case occurred at a time when captive customers of many different pipelines, excluded from participation in SMPs, suffered the same kind of discrimination without remedy. Accordingly, in these circumstances, equity hardly requires imposing a remedy for only the parties involved in this case.

CONCLUSION

For the reasons explained above, the Commission's orders should be affirmed in all respects.

Respectfully submitted,

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