Distributor Bypass in the Deregulated Natural Gas Industry – Are Consumers Being Left in the Cold?

Martin V. Kirkwood

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The Natural Gas Act of 1938 (NGA)\(^1\) regulates the natural gas industry. From the wellhead to the city gate,\(^2\) the NGA regulates the sale for resale, and the transportation of natural gas in interstate commerce.\(^3\) By enacting the NGA, Congress intended to regulate the natural gas industry specifically to protect consumers from anticompetitive practices of natural gas pipelines and to ensure consumers reliable and secure supplies of natural gas at the lowest reasonable price.\(^4\) Accordingly, the NGA's "prime constituency" is the consumer.\(^5\)

Since the early 1980's, the Federal Energy Regulatory Commission (Commission), the federal agency responsible for implementing the NGA, has eliminated or revised regulations it had previously imposed on the industry.\(^6\)

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2. The wellhead is the point of the natural gas production. The city gate is the point where the interstate pipeline completes its interstate transportation and where the local distribution company begins its intrastate natural gas service.
3. 15 U.S.C. § 717(b) states:
   The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.
4. FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944) ("The primary aim of this legislation was to protect consumers against exploitation at the hands of natural gas companies."). Congress' intent was that "natural gas should be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest" and to afford consumers a "complete, permanent and effective bond of protection from excessive rates and charges." Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378, 388 (1959) (quoting original text of NGA, 52 Stat. 825 (1938)).
The deregulatory initiatives developed partly in response to evolving market structures, and partly in response to changing Commission policy which increasingly allows market competition, rather than government regulation, to "regulate" the industry. As a result of industry deregulation, the Commission more readily allows industrial consumers to "bypass" their traditional local distribution companies (LDC) and to purchase natural gas directly from the LDC’s pipeline supplier. LDC bypass means fewer customers share the costs associated with maintaining the LDC’s facilities. Consequently, the costs that the remaining customers pay increases. In the past, the Commission was concerned about the increased costs to residential consumers caused by LDC bypass, and refused to permit the bypass. In the new deregulated market, however, the Commission is less concerned about increased costs associated with LDC bypass and is more interested in enhancing competition in the marketplace as the method to control consumers’ costs.

Yet, in light of the NGA’s congressional directive to protect consumers, the question arises whether the Commission’s change in policy and more readily allowing LDC bypass complies with its statutory mandate. As


7. See, e.g., Order No. 436, supra note 6, at 42,413 (indicating that the Commission is changing its traditional public utility form of regulation to allow competitive forces to play a role in regulating); see also Fox, Transforming an Industry by Agency Rulemaking: Regulation of Natural Gas by the Federal Energy Regulatory Commission, 23 LAND & WATER L.R. 113, 118 (1988) (indicating that the Commission had changed in the early 1980’s from Carter-appointed Commissioners to Reagan-appointed Commissioners, and that the Reagan appointees shared and implemented President Reagan’s views of less governmental regulation of business).

8. See infra text accompanying notes 49-50.

9. Order No. 436, supra note 6, at 42,413.

10. See supra notes 3-5 and accompanying text.

11. A similar question has been raised in efforts to deregulate other regulated industries as well. See Broadman & Kalt, How Natural is Monopoly? The Case of Bypass in Natural Gas Distribution Markets, 6 YALE J. ON REG. 181 (1989) (citing entry deregulation as an issue in the reform of the telecommunications, postal, cable, and electric industries). For example, in Public Utility Commission of Texas v. FCC, 886 F.2d 1325 (D.C. Cir. 1989), an industrial customer bypassed its local telephone exchange by transmitting its telephone signals via its own microwave facilities. The Public Utility Commission of Texas attempted to require the industrial user to return to the local exchange, arguing that if the industrial customer could
consumers increase natural gas use because it is a cost-efficient and environmentally safe fuel, the Commission's new policy regarding LDC bypass and its reliance on competitive pressures will become more significant to natural gas consumers.  

This Comment addresses whether the Commission's new LDC bypass policy is consistent with the congressional mandate of the NGA. It begins with an analysis of the structure of the natural gas industry, emphasizing the role of the LDC. Next, it addresses the purposes behind the passage of the NGA and Congress' accompanying concerns. This Comment then reviews the Commission's historic preference against LDC bypass, and recent changes in the natural gas market which set the stage for the Commission's change in its LDC bypass policy. This Comment then examines the rulemaking order which provides the basis for the Commission's change in policy, and analyzes several recent bypass cases. This Comment concludes that, while certain participants in the natural gas industry, such as industrial customers and interstate pipelines, can take advantage of the newly deregulated market, other segments of the industry, such as residential consumers, cannot. Therefore, because residential consumers cannot realistically compete in the new deregulated market, they continue to require regulatory protection. If the Commission is unwilling to protect the residential consumers, then the states should be permitted to take a more active role in ensuring consideration of consumer interests.

I. THE NATURAL GAS INDUSTRY

A. The Industry in a Nutshell

Natural gas serves as a significant energy source in America today. Although it was once burned off as an unwanted by-product of petroleum production, natural gas now fulfills almost a quarter of the nation's energy needs. Natural gas is often referred to as a clean-burning fuel because,
Unlike oil and coal, it does not emit large amounts of carbon dioxide when burned. In an environmentally conscious America, natural gas is quickly becoming the fuel of choice.\textsuperscript{16}

Historically, the natural gas industry has been comprised of several segments which, working together, have produced, transported, and distributed natural gas to consumers.\textsuperscript{17} Each segment of the industry plays a significant but distinct role, and each operates in a different regulatory environment.\textsuperscript{18} Because of the series of actors involved in the natural gas market from the point of production to the point of consumption, natural gas is bought and sold several times from production to ultimate consumption.\textsuperscript{19}

Traditionally, the first actors in the movement of natural gas to consumers are the producers. Producers explore, drill, produce, and sell natural gas to interstate pipelines. While producers were initially free from federal regulation, the Supreme Court in 1954 held certain natural gas producers subject to federal price controls.\textsuperscript{20} Subsequently, however, Congress enacted the Natural Gas Wellhead Decontrol Act of 1989, which effectively reversed the 1954 Court opinion.\textsuperscript{21}

The next segment of the natural gas industry is the interstate pipelines, which are regulated by the Commission.\textsuperscript{22} The interstate pipelines purchase gas from producers at the wellhead,\textsuperscript{23} or from other pipelines. The purchasing pipeline transports the gas to the LDCs, or to large industrial customers.\textsuperscript{24} Because interstate pipelines function both as purchaser of natural gas for resale and as transporter of gas to customers, the pipeline traditionally

\textsuperscript{15} R. PIerce, Jr., G. ALLISON & P. MARTIN, ECONOMIC REGULATION: ENERGY, TRANSPORTATION AND UTILITIES 456-57 (1980) [hereinafter R. PIece, Jr.]. Natural gas is sold by volume, typically by million cubic feet (Mcf). It takes approximately one (1) Mcf of gas per day to fuel a residential customer's household during cold weather. \textit{Id.}


\textsuperscript{17} See Fox, supra note 7, at 114; see also R. Pierce, Jr., supra note 15, at 455.

\textsuperscript{18} See AMERICAN GAS ASSOCIATION, GAS RATE FUNDAMENTALS 91-92 (4th ed. 1987).

\textsuperscript{19} Pierce, Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry, 97 HARV. L. REV. 345, 348 (1983).

\textsuperscript{20} Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954). In this controversial opinion, the Court held that the Commission has jurisdiction over the wellhead price of natural gas. Such pricing was previously thought to be a state issue, and outside of the Commission's jurisdiction. After the decision, the Commission embarked on an ambitious program to set wellhead prices. See Pierce, Reconstituting the Natural Gas Industry from Wellhead to Burner-tip, 9 ENERGY LJ. 1, 8-10 (1988).


\textsuperscript{22} See 15 U.S.C. § 717(b) (1988); supra note 3.

\textsuperscript{23} See supra note 2.

\textsuperscript{24} W. Fox, FEDERAL REGULATION OF ENERGY § 1502, at 425 (1983).
has acted more as a gas merchant. Recently, however, interstate pipelines have offered their transportation and sales services separately, and today many act more as transporters than as merchants.

In the final segment of the market, LDCs purchase the gas directly from interstate pipelines, and then resell and distribute the gas to customers within their service territory. Because of the intrastate nature of local distribution, LDCs largely remain free from federal jurisdiction and are regulated by their state utility commissions. In a number of opinions, the Supreme Court has determined that local distribution commences when the gas leaves the high pressured interstate pipelines and enters the lower pressured LDC pipeline facilities.

The structure of the local gas market is a significant factor in analyzing the issue of LDC bypass. LDCs traditionally purchased their gas from the interstate pipelines and then resold and distributed it to residential and industrial consumers on their local pipeline distribution system. A typical LDC consists of in-state transportation pipelines and other plant facilities used in distributing and selling gas to its customers. The utility incurs costs in operating and maintaining its facilities, as well as in running the business. These costs are passed on to the LDC's customers through the utility's rates.

In the local market, LDCs serve two main categories of customers: Industrial customers, such as businesses and factories, and residential consumers. These two groups make different demands on the LDC for service, but both benefit from a varied customer mix. For example, because many in-

25. Pierce, supra note 19, at 348.
27. See, e.g., ILL. REV. STAT. ch. 111 2/3, para. 4-101 (1988); MICH. COMP. LAWS. § 460.6 (1990).
28. See, e.g., East Ohio Gas Co., 338 U.S. at 469-70 ("[W]hat Congress must have meant by 'facilities' for 'local distribution' was equipment for distributing gas among consumers within a particular local community, not the high-pressure pipe lines transporting the gas to the local mains."); see also Lindh, Federal Preemption of State Regulation in the Field of Electricity and Natural Gas: A Supreme Court Chronicle, 10 ENERGY L.J. 277, 306-09 (1989) (chronicling the Court's opinions addressing where federal regulation of natural gas ends and where state regulation begins).
29. J. TOMAIN, J. HICKEY & S. HOLLIS, ENERGY LAW AND POLICY, 166 (1988) [hereinafter J. TOMAIN]. A utility's operating costs typically comprise 75% to 80% of its rate. Id.
30. See Broadman & Kalt, supra note 11, at 200.
31. Id.
Industrial customers can switch between using fuel oil and natural gas for their energy needs, industrial customers have an intermittent or elastic demand for natural gas.\textsuperscript{32} Residential consumers have a steadier, inelastic demand for natural gas.\textsuperscript{33} Because of the LDC's obligation to serve,\textsuperscript{34} its facilities are constructed to provide natural gas concurrently for both residential and industrial customers. At times of limited industrial use, local pipeline facilities would sit idle unless the LDC had residential consumers to serve. Thus, because the residential customers offset some of the LDC's costs, the industrial customers benefit from the LDC's residential consumers. Residential consumers likewise benefit when industrial customers use the LDC's system; with more users on its system, the LDC has a larger group from which to recover its fixed costs. As a result, the LDC allocates a smaller portion of its fixed costs to each customer.

Utilities are state authorized monopolies.\textsuperscript{35} Many state utility commissions grant LDCs exclusive franchises to serve particular geographic areas to avoid having competing LDC pipeline facilities criss-crossing their states.\textsuperscript{36} The issuance of an exclusive franchise, however, requires the LDC to serve any person requesting service and commits the LDC to regulatory oversight.\textsuperscript{37} This requirement is often referred to as the public service obligation.\textsuperscript{38} Because of the public service obligation, the LDC must be ready to provide service to all possible customers, and must maintain adequate supplies or "contract demand" of natural gas to serve all of its customers.\textsuperscript{39} Moreover, an LDC often remains obligated to purchase its contract demand from its pipeline, regardless of customer demand.

State utility commissions regulate the LDCs' rates to ensure that the LDCs do not exploit their monopoly position.\textsuperscript{40} In setting an LDC's rates, the state utility commission reviews the LDC's costs and sets a rate that allows the LDC the opportunity to cover incurred costs and to earn a reasonable rate of return on its capital investment.\textsuperscript{41} The rate typically consists

\textsuperscript{32} Id. at 185.
\textsuperscript{33} Id.
\textsuperscript{34} See infra notes 37-38 and accompanying text.
\textsuperscript{36} P. Garfield & W. Lovejoy, supra note 35, at 12.
\textsuperscript{37} Id. at 13; see also J. Tomain, supra note 29, at 159.
\textsuperscript{38} J. Tomain, supra note 29, at 159.
\textsuperscript{39} Id.; see also P. Garfield & W. Lovejoy, supra note 35, at 13.
\textsuperscript{40} See A. Kahn, The Economics of Regulation, Volume 1, 21 (1970); J. Tomain, supra note 29, at 165-66.
\textsuperscript{41} See Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n, 262 U.S. 679, 690 (1923); Smyth v. Ames, 169 U.S. 466, 546-47 (1898); see also J. Tomain, supra note 29, at 159-66. Under basic rate making methodologies, utilities such as LDCs are guaranteed
of two parts: A fixed cost, for example, a monthly service charge; and a commodity cost, for example, a charge for each additional unit of natural gas purchased. In setting the LDC's rates, a state utility commission often requires an LDC to maintain different rates for different categories of customers. Many state utility commissions, in an effort to keep residential rates low, choose to allocate some of the costs LDCs incur in serving residential customers to the LDCs' industrial customers.

B. The Structure of an LDC Bypass

Because of the uneven allocation of costs, some industrial customers become dissatisfied with their LDC rate and seek more competitively priced natural gas alternatives. Industrial LDC customers who have the capability to construct a direct hookup to the interstate pipeline can bypass the LDC. The industrial customer can thus avoid the "middleman," and mark-up, by purchasing lower priced natural gas directly from the interstate pipeline. In order to bypass the LDC, however, the customer must not only the opportunity to recover these fixed costs through their rates. J. Tomain, supra note 29, at 166. The methodologies used to set the rates are based on cost, investment, margin or, most recently, on the level of competition existing in a utility's market area. Id.

42. American Gas Association, supra note 18, at 180.

43. State utility commissions often use their authority to set rates to achieve political as well as economic ends. J. Tomain, supra note 29, at 164. For example, state utility commissions can, and often do, allocate a disproportionate share of the LDC's fixed costs to the industrial customers to keep the rates of the residential consumers at the level the commissions perceive to be reasonable. Professor Tomain lists four goals to consider in rate setting: Ensuring reliable public service, controlling monopoly power, avoiding economic waste, and redistributing wealth. Id. at 161-62; see also A. Kahn, supra note 40, at 55-56. Professor Kahn suggests that:

All too often, from the economist’s standpoint, the commissions resolve such controversies on bases other than economic efficiency, seeking to protect offended competitors from excessive losses of business, to preserve a "fair share" of the market for each, to strike some equitable or politically acceptable distribution of common costs among the various classes of patrons.

Id.

44. See Pierce, supra note 20, at 49; see also S. Williams, The Natural Gas Revolution of 1985 25 (1985).

45. See Broadman & Kalt, supra note 11, at 182.

46. Bypass can actually occur in several forms. For example, while bypass is generally a method through which a customer changes from its traditional seller to another seller, bypass can also be achieved by the customer manufacturing its own supplies (synthetic gas), thereby eliminating the need for the seller's services. Additionally, bypass can be achieved by the customer switching from natural gas to an alternate fuel supply. See Broadman & Kalt, supra note 11, at 195. This Comment does not analyze these types of bypass, but analyzes LDC bypass in the context of an industrial enduser constructing a direct hookup with an interstate pipeline and where the LDC is willing and able to continue to serve the industrial enduser.
possess the financial resources to pay for the hookup, 47 but also must have a high volume demand for gas to warrant the hookup costs. Further, the customer must have the market experience and expertise to operate the hookup and arrange for natural gas supplies. 48 Because of the expense involved, the only customers realistically able to bypass the LDC are larger industrial customers; these customers, in contrast to the residential consumers, are more likely to have the resources, the demand, and the business acumen necessary to bypass the LDC. Residential consumers and small commercial endusers, unable to afford or warrant a direct hookup with the interstate pipeline, will remain limited or "captive" to the LDC. Furthermore, they will remain captive to the LDC's costs. As industrial customers leave the LDC system, costs previously paid by the departing customers shift to the remaining customers. As a result, remaining customers experience higher rates. 49 Higher rates can cause industrial customers not contemplating bypass to consider bypassing the LDC. As more customers leave the system, more costs shift to the remaining customers, resulting in a spiraling increase in natural gas rates. 50

Although LDC bypass negatively affects the residential consumers, the LDC bypass may carry certain economic benefits. 51 An industrial customer will bypass the LDC if, by doing so, it can purchase gas at lower rates. 52 Thus, if an industrial customer can get cheaper fuel, it may pass the benefit of the lower fuel costs on to its customers or to its employees through either a decrease in the price of its manufactured product or, alternatively, by paying higher wages to its employees, hiring more employees, or avoiding em-

47. For example, in one LDC bypass case, the cost of installing six feet of pipeline facilities was $81,000. Northern Natural Gas Co., 46 F.E.R.C. ¶ 61,270 at 61,792 (1989).


49. See, e.g., Panhandle E. Pipe Line Co., 38 F.E.R.C. ¶ 63,009, at 65,039 (1987) (predicting that a bypass in this proceeding will result in the LDC suffering a loss of $51 million in annual revenues and that the loss would be made up by shifting the costs to customers remaining on the system).

50. Id.

51. See Broadman & Kalt, supra note 11, at 204-06.

52. See, e.g., id. at 204 (stating that "[b]eneficial rate effects result from the ability of actual or prospective bypass to lower the marginal expense of delivered gas to bypassing end-users").
ployee layoffs. Moreover, when fuel costs are high, an industrial customer may shutdown its operations if it is unable to cover its fuel costs. Obtaining cheaper fuel via a bypass may enable the industrial enduser to remain in operation and continue to contribute to the local economy as an employer and a taxpayer. Ultimately, however, while these positive effects of bypass are indirect and speculative, the negative effects are more direct and certain.

An industrial customer can bypass an LDC via one of several regulatory mechanisms. First, under section 7 of the NGA, the interstate pipeline bypassing the LDC to the industrial customer could request a certificate of public convenience and necessity from the Commission. This traditional certification process is time consuming and expensive. In the alternative, the pipeline could request a certificate pursuant to the Commission's optional expedited certificate (OEC) regulations. The OEC procedure was designed to be faster than the traditional process because Commission review under the OEC procedure is less stringent than review of a section 7 certificate application. Finally, the pipeline could bypass the LDC under the self-implementing authority provided in section 311 of the Natural Gas Policy Act of 1978. Under section 311, an interstate pipeline can transport

54. Id.
55. Id.
56. 15 U.S.C. § 717f(c) (1988). Section 7(c) requires that a party must obtain a certificate of public convenience and necessity before it commences service and before it constructs facilities to effect the service. Id.; see infra note 79.
57. See Associated Gas Distribs. v. FERC, 899 F.2d 1250, 1254 (D.C. Cir. 1990) (indicating that the section 7 process requires burdensome and extensive filings and administrative hearings before the transaction can commence), cert. denied sub. nom Berkshire Gas Co. v. Assoc. Gas Distribs., 111 S. Ct. 277, 278 (1990).
58. The OEC mechanism was created in Order No. 436. See infra text accompanying notes 139-43. The OEC procedures are codified at 18 C.F.R. § 157.100 to 157.106 (1990).
59. 15 U.S.C. § 3371 (1988). In relevant parts, section 311 provides:
(a) Commission approval of transportation.-
(1) Interstate pipelines.-
   (A) In general.
   The Commission may, by rule or order, authorize any interstate pipeline to transport natural gas on behalf of—
   (i) any intrastate pipeline; and
   (ii) any local distribution company.
   . . . .
(2) Intrastate pipelines.
   (A) In general.
   The Commission may, by rule or order, authorize any intrastate pipeline to transport natural gas on behalf of—
   (i) any interstate pipeline; and
   (ii) any local distribution company served by any interstate pipeline.
   . . . .
and sell natural gas "on behalf of" an intrastate pipeline or an LDC without obtaining prior approval from the Commission. This method provides the quickest and easiest manner of bypass and many of the bypass cases are pursuant to section 311.

II. THE NATURAL GAS ACT OF 1938

Prior to 1938, the interstate natural gas market was largely unregulated. Relatively few interstate natural gas pipelines spanned the nation, and those pipelines that did so had a tight grip on their markets. Several states had attempted to regulate the sale of natural gas into their jurisdictions by setting the rates that interstate pipelines could charge in-state consumers. Because the sale of natural gas from outside state borders to in-state consumers

(b) Commission approval of sales.

(1) In general.

The Commission may, by rule or order, authorize any intrastate pipeline to sell natural gas to —

(A) any interstate pipeline; and

(B) any local distribution company served by any interstate pipeline.

60. The pipeline need only report to the Commission within 30 days of the commencement of the transaction. 18 C.F.R. § 284.106(a) (1990).

61. Bypass achieved through section 311 may have been limited by the United States Court of Appeals for the District of Columbia Circuit in Associated Gas Distributors, 899 F.2d at 1250. Under section 311, an interstate pipeline can transport or sell natural gas to an industrial customer if the pipeline is transporting or selling the gas "on behalf of" an intrastate pipeline or an LDC. 15 U.S.C. § 3371(a)(1) (1988). The Commission previously interpreted the "on behalf of" clause to require only that the party on whose behalf the gas is transported receive "some economic benefit" from the transaction. Hadson Gas Sys., Inc., 44 F.E.R.C. 61,082 at 61,250 (1988), reh'g, 45 F.E.R.C. ¶ 61,286 (1988). Under the Commission's standard, a pipeline could serve an industrial customer on behalf of an LDC without any physical connection to the transaction. In Associated Gas Distributors, the court rejected the Commission's broad "some economic benefit" test. The court reasoned that section 311 is a limited exception to section 7, and that the Commission's broad reading of section 311 undermined the section 7 certificate process. Associated Gas Distributors, 899 F.2d at 1261. Accordingly, the court remanded the case to the Commission to fashion an appropriate standard. On remand, the Commission issued an interim rule revising its section 311 test. Interim Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates, 55 Fed. Reg. 33,002 (1990) (to be codified at 18 C.F.R. §§ 284.102, 284.223). The interim regulations require that the "on behalf of" party either: (1) have physical custody of the gas at some point in the transaction; or (2) hold title to the gas at some point during the transaction. Id. at 33,006. Further, if the party on whose behalf the gas is transported only holds title to the natural gas and not physical custody, it must hold title to the gas "for . . . purpose[s] related to its status as an LDC or intrastate pipeline." Id. The Commission has also requested comments to further develop the standard. 55 Fed. Reg. 33,017 (1990). The court's order limiting section 311 could eliminate up to one-third of section 311 transactions. Inside F.E.R.C., (McGraw-Hill) Aug. 13, 1990, at 3.

62. See Pierce, supra note 20, at 6.

63. Pierce, supra note 19, at 345.

64. Pierce, supra note 20, at 5.
was interstate commerce, the United States Supreme Court rejected the states' attempts to regulate the natural gas industry as violative of the commerce clause.\textsuperscript{65} The Court's opinions not only secured the monopoly position of the few interstate pipelines that served the United States, but also prevented state authorities from protecting their consumers from monopolistic market conditions.\textsuperscript{66}

The states whose consumers were subject to the unfair practices of the interstate pipelines did not end their fight with the Court opinions. Alleging that the interstate pipelines engaged in price or transportation discrimination against them,\textsuperscript{67} LDCs and state agencies complained to Congress about the dominant market power of the interstate pipelines and the states' lack of power to protect their consumers.\textsuperscript{68} In response to state and consumer complaints and pleas for assistance, Congress asked the Federal Trade Commission (FTC) to investigate the market practices of interstate natural gas pipelines.\textsuperscript{69}

The FTC reported that interstate pipelines regularly engaged in unfair and discriminatory practices against LDCs and, ultimately, natural gas consumers.\textsuperscript{70} Moreover, because of the size of the interstate pipelines and the lack of pipeline competitors, the FTC concluded that interstate pipelines exercised monopoly power.\textsuperscript{71} The FTC also found that because of Supreme Court decisions that solidified the pipelines' market power,\textsuperscript{72} state utility commissions and consumers were helpless in controlling the power of the interstate pipelines. According to the FTC, a federal response was necessary to curtail the monopolistic practices of interstate pipelines and to provide consumer protection.\textsuperscript{73}


\textsuperscript{67} Id.

\textsuperscript{68} Pierce, supra note 20, at 5.

\textsuperscript{69} Interestingly, the FTC had previously recommended to Congress that it regulate producers and interstate pipelines in 1928. However, the Congress of 1928 apparently was not interested in imposing any controls on the industry. See Fox, supra note 7, at 114 n.9.

\textsuperscript{70} S. Doc. No. 92, 70th Cong., 1st Sess. pt. 84-A (1936).

\textsuperscript{71} Id. at 615-16.

\textsuperscript{72} Id. at 616-17.

\textsuperscript{73} Id. at 617; see also FPC v. Hope Natural Gas Co., 320 U.S. 591, 610 (1944) (analyzing legislative history to determine the NGA's role as a consumer protection statute).
Responding to the lack of competition in the natural gas market identified in the FTC report, Congress passed the NGA in 1938. Congress' primary goals in enacting the NGA were "to protect consumers against ... exploitation at the hands of [interstate pipelines]" and "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." Under the NGA, the Commission regulates the natural gas industry in the absence of competition, to ensure the types of consumer protection that a true competitive market may provide. While the NGA gave the Commission control over the sale and transportation of natural gas in interstate commerce, the NGA specifically left to state commissions the power to regulate retail sales of natural gas within the state.

Pursuant to section 7 of the NGA, the Commission regulates the transportation of natural gas in interstate commerce by requiring interstate pipelines to obtain a certificate of "public convenience and necessity" before commencing service. This provision also requires interstate pipelines to seek approval prior to terminating or "abandoning" pipeline facilities, sales, and transportation service. The Commission has developed its bypass policy under its section 7 authority.

III. EARLY ATTEMPTS AT LDC BYPASS AND THE DEVELOPMENT OF THE COMMISSION'S HISTORIC PREFERENCE AGAINST LDC BYPASS

Under section 7 of the NGA, the Commission can refuse to permit an interstate pipeline to sell or transport natural gas in interstate commerce if it finds that the transaction is not in the "public convenience and necessity."  

75. Hope Natural Gas, 320 U.S. at 610.  
77. See A. KAHN, supra note 40, at 20.  
78. See supra note 3.  
79. 15 U.S.C. § 717f(c)(1)(A) (1988). In pertinent part section 7f(c)(1)(A) provides:  

No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or the sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations . . . .

Id.

81. See id. § 717f(c)(1)(A); supra note 79.
In a series of early cases, the Commission rejected bypass proposals and held that increased costs to consumers, diminution in quality of service, and duplication of facilities weigh heavily against LDC bypass being in the "public convenience and necessity."

For example, in *American Louisiana Pipe Line Co.*, the FPC refused to permit an interstate pipeline to hookup directly with industrial customers already being served by an LDC because the bypass would increase the rates of natural gas to the LDC's residential consumers. In *American Louisiana*, a number of interstate pipelines filed applications pursuant to section 7 of the NGA requesting certificates to construct pipeline facilities and to transport and sell natural gas in interstate commerce. One of the pipeline applicants, Midwestern Gas Transmissions Company (Midwestern), requested authority to sell natural gas directly to several steel mills near Chicago. Three LDCs already served those steel mills. The LDCs opposed Midwestern's proposed bypass and argued that direct sales "would displace very large and important off-peak sales" made by the LDCs to the steel mills. They indicated that the gas sales to the steel mills accounted for 10% of their annual sales.

Rejecting Midwestern's proposal to serve the steel factories directly, the Commission held that the proposed hookup was not "consistent with the public convenience and necessity." Specifically, the agency acknowledged the harm of bypass to the LDCs and, more significantly, the harm to the LDCs' remaining customers in the form of higher rates. Therefore, because the LDCs' remaining customers would have been adversely affected by the bypass, the Commission was unwilling to permit the bypass to occur.

The Commission has also refused to permit LDC bypass where the facilities necessary to bypass the LDC would duplicate existing pipeline facilities.

83. 20 F.P.C. 575, 592 (1958).
84. Id. at 579.
85. Id. at 592.
86. Id.
87. Id.
88. Id.
89. Id. The Commission found "[t]he steel sales are important to the distributors, for such interruptible sales improve the load factors to the benefit of the low load factor commercial and domestic consumers. It is indicated that loss of the steel sales might require the distributing companies to raise their rates." Id.
90. Id. The Commission also refused to permit the bypass because it would "disturb the market balance which now exists between industrial and residential customers." Id.; see also *Natural Gas Pipeline Co.*, 34 F.P.C. 771, 778 (1965).
The Commission has avoided facility duplication because installing two different pipeline facilities to perform a function that one set of facilities could achieve results in economic waste and increased costs for consumers. In *Southern Natural Gas Co.*, Southern Natural, an interstate pipeline, proposed to sell natural gas directly to two industrial customers in Georgia. The industrial customers, however, were within the service territory of an LDC already served by Southern Natural. The LDC offered to substitute its service for the service proposed by Southern Natural. The Commission concluded that Southern Natural's bypass of the LDC was not in the public convenience and necessity.

Before the Commission addressed the case, a Commission examiner reviewed the facts and found that the LDC, South Atlantic, rather than the interstate pipeline, Southern Natural, should sell the gas to the two companies to prevent cost shifting and duplication of facilities. On review of the examiner's findings, however, the Commission clarified the examiner's decision, emphasizing that the Commission did not maintain a policy that a distributor, rather than the interstate pipeline, must always serve the industrial customers in its service territory. Instead, the Commission held that bypass proposals would be reviewed on a case-by-case basis. The Commission further explained, however, that it would not approve a bypass that would result in a duplication of facilities and an increase in the rates of remaining customers.

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91. See, e.g., Broadman & Kalt, supra note 11, at 206-07; see also A. Kahn, supra note 40, at 119-23.
93. Id.
94. Id.
95. The examiner was a precursor to the current Administrative Law Judge. See 18 C.F.R. § 385.102(c) (1990).
96. *Southern Natural*, 25 F.P.C. at 937. The examiner found:
In principle, lines of interstate transmission companies should not be laid down on top of local distribution lines for the service of profitable industrial load that can be served by the local distributor. On the contrary, such load, absent unusual circumstances not now foreseen, should be served by the distribution company, to the benefit of the local consumers in respect of (a) its increased revenues and profits taken into account by State Commissions in fixing rates and (b) its improved load factor, reducing its unit cost of service. *Id.* (citing *American La.*, 20 F.P.C. at 588, 592 (1958)).
97. Id. at 927.
98. *Id.* The Commission held:
Where the local distributor indicates that it is willing and able to serve a particular industrial customer located in the area covered by the distributor's existing system, there is certainly no reason, absent the unusual circumstances mentioned by the examiner, for the Commission to authorize duplicative construction of facilities by the interstate pipeline to serve an industrial customer which can be served adequately by
While the Commission shied away from announcing an agency policy against LDC bypass, *Southern Natural* clearly reflected an agency preference for LDCs to service industrial customers where additional costs can be avoided.\(^9\) The benefits to the LDC's customers, lower costs resulting from additional high load customers on the system and increased revenue generated by industrial users, figured prominently in the Commission's preference.\(^10\) Likewise, the prevention of duplicate facilities spanning service areas and the resulting economic waste were significant factors in the Commission's early LDC bypass orders.\(^11\)

In a later case, the Commission strengthened its LDC bypass preference. In *Panhandle Eastern Pipe Line Co.*,\(^12\) the Commission once again addressed an LDC bypass when Panhandle sought a certificate of public convenience and necessity to render natural gas service to a brick manufacturer in Fulton, Missouri. The City of Fulton, a municipal natural gas distributor, filed an application requesting authority to provide the same service. Fulton asked that Panhandle's application be denied or, in the alternative, that Panhandle be ordered to provide the service to Fulton, which, in turn, would provide the service to the brick manufacturer.\(^13\) Reasoning that Panhandle would best serve the brick maker, the examiner determined that Panhandle's application should be approved.\(^14\)

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10. *Id.*
11. The United States Supreme Court has also recognized the disadvantages of LDC bypass. See *Panhandle E. Pipe Line Co. v. Michigan Pub. Serv. Comm’n*, 341 U.S. 329 (1951). The Court, in holding that a state utility commission could regulate the bypass of an LDC, acknowledged that if the bypass were permitted, not only would there be two utilities using local facilities to accommodate their distribution systems, but also that the utilities would be seeking to serve the same industrial consumers. The Court stated:

[The pipeline] asserts a right to compete for the cream of the volume business without regard to the local public convenience or necessity. Were [the pipeline] successful in this venture, it would no doubt be reflected adversely in [the LDC's] over-all costs of service and its rates to customers whose only source of supply is [the LDC]. *Id.* at 334. Therefore, the Court's concern was similar to the Commission's: if the pipeline is permitted to "skim the cream" of the LDC's customers and serve them directly, the remaining customers would unfairly be stuck with higher rates. *Id.*

13. *Id.* at 1108.
14. *Id.* at 1125.
Citing the deficiency of the record developed at the hearing, however, the Commission rejected the examiner's findings. Instead, the Commission, departing from its hesitancy in *Southern Natural* to announce a policy against LDC bypass, stated: "[o]ur policy to favor service to industrial customers by local distributors is well established." Applying that "policy" to Panhandle's and Fulton's applications, the Commission ordered Panhandle to serve Fulton to enable the City to serve the brick manufacturer.

The series of cases addressing LDC bypass reveal a Commission preference for the LDC, rather than the interstate pipeline, to serve industrial customers. In developing its preference, increased costs to remaining consumers after the bypassing customer departed was a significant factor in the Commission's analysis. The cases reveal that the Commission's LDC preference was not designed necessarily to protect the LDCs from market powers. Rather, the preference was designed to protect residential consumers, the ones most harmed by LDC bypass. Further, while the Commission did not automatically reject all LDC bypass proposals in the early cases, it did consider the impact of bypasses on all segments of the natural gas industry and acted to protect adversely affected segments.

105. *Id.* at 1109.
106. *Id.* at 1109 (citing Northern Natural Gas Co., 33 F.P.C. 501 (1965); Southern Natural Gas Co., 25 F.P.C. 925 (1961); Panhandle E. Pipe Line Co., 13 F.P.C. 301 (1954)).
107. *Id.*
108. This distinction is borne out by the fact that the LDC preference would not be invoked if the LDC's residential customer would benefit from the bypass. In Alabama Gas Corp. v. Southern Natural, 49 F.P.C. 686 (1973), an LDC asked the Commission to order an interstate pipeline to serve three industrial customers through the LDC rather than to sell gas directly to the customers. 49 F.P.C. 686. The LDC asserted that the Commission's LDC preference required the LDC to serve the customers. *Id.* The Commission rejected the LDC's request. Although the Commission acknowledged its policy "to favor service to industrial customers through local distributors," it also acknowledged that "[t]he policy of this Commission which protects the right of the local distributor to render sales to industrial customers within its area of service is conditional—it does not apply if economic considerations preclude it." *Id.* (quoting Panhandle E. Pipe Line Co., 36 F.P.C. 1107, 1112 (1966)). The economic considerations that the Commission relied on in refusing to order the pipeline to use the LDC were the impact on the pipeline of losing the direct sales service and the concern that, if the LDC had too much industrial load, then the LDC's high-priority customers would be harmed during curtailment periods. *Id.* at 687. Significantly, even when the Commission did not order use of the LDC, the impact of the bypass proposal on the residential consumer was a factor in the Commission's analysis. That is why the Commission, in other LDC bypass proceedings, maintained that it would not rigidly adhere to the LDC preference, and that it would review each proposed LDC bypass on a case-by-case basis. See also Missouri Edison Co., 47 F.P.C. 849, 851-52 (1972) (considering economic and gas supply considerations for both industrial and residential customers).
IV. CHANGES IN THE NATURAL GAS MARKET: AGENCY RESPONSES TO THE DEVELOPING MARKET AND THE COMMISSION’S RESULTANT CHANGE IN LDC BYPASS PREFERENCE

Lack of competition in the natural gas market for consumers prompted Congress to enact the NGA. In the years after 1938, and particularly since the late 1970’s, the interstate natural gas market changed radically. In certain sections of the market, competitive forces increased and direct governmental control over the market as a means to prevent monopoly pressures became anachronistic.

One way the natural gas industry changed was through the development of a competitive market at the wellhead. As the Commission sought to regulate the interstate market under the NGA, the intrastate market was left to state regulation. Because producers and pipelines could charge higher, unregulated prices for gas not entering the interstate market, some refused to sell their natural gas on the interstate market. Producers and pipelines could choose either to sell or transport gas in interstate commerce at relatively lower regulated prices and be subject to the full panoply of Commission regulations, or to limit their activities to the intrastate market where they could sell their gas at higher prices without having to comply with federal controls. Consequently, while natural gas was plentiful on the intrastate market, natural gas shortages developed on the interstate market.

In response to chronic natural gas shortages, Congress passed the Natural Gas Policy Act of 1978 (NGPA). Congress’ goal under the NGPA was to encourage production of natural gas to satisfy demand on the interstate

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110. See Pierce, supra note 19, at 348. Professor Pierce argues that regulation of the natural gas market can no longer be based on a “monopoly rationale.” Instead, he maintains that changes in the market in recent years have resulted in a sufficiently competitive market which no longer justifies direct governmental market regulation. Id.

111. Between 1969 and 1976, the price of natural gas on the interstate market increased 600%, from 19.8 cents per Mcf to $1.42 per Mcf. Gas on the intrastate market, however, increased over 1,200%, from 18 cents per Mcf to $2.39 per Mcf. See S. REP. No. 436, 95th Cong., 1st Sess. 8 (1977).

112. See Fox, supra note 7, at 116.

113. Id.; see also Note, Deregulation and Natural Gas Purchase Contracts: Examination Through Neoclassical and Relational Contract Theories, 25 WASHBURN L.J. 43, 45 (1985). The natural gas shortages on the interstate market became particularly acute during the energy crises of the 1970s brought on by oil shortages, and when historical purchasers of fuel oil attempted to switch from oil to natural gas for their energy needs. At the same time, the demand for natural gas increased to comply with air quality standards. Id. at 44 n.12.

To increase gas supplies, Congress raised the wellhead price of natural gas to more competitive levels and set economic incentives for producers to produce more gas. The NGPA also eliminated price controls on certain categories of gas effective January 1, 1985, and designated another category of gas for deregulation in 1987. Congress also eliminated the distinction between the interstate and intrastate market that contributed to shortages on the interstate market. Pursuant to the NGPA, parties may transport natural gas in the interstate market without becoming subject to NGA jurisdiction.

During the phased decontrol mandated by the NGPA, the natural gas market changed rapidly. The chronic natural gas shortages of the early and mid-1970's developed into a surplus by the early 1980's. The surplus, however, was of “new” gas, which, under the NGPA, was priced considerably higher than the regulated “old” gas supplies. Simultaneously, as production of natural gas increased, demand decreased. During the shortage, interstate pipelines signed long-term contracts with natural gas producers to “lock-in” supplies of the new gas. Once demand declined, the interstate pipelines remained obligated to purchase large volumes of high priced natural gas pursuant to long-term contracts. Because the price was so high and overall demand was declining, few customers were willing to take the supplies.

One result of the market changes was the development of the “spot market” for natural gas. In the spot market, producers attempted to sell their gas for short-terms and at prices lower than contract prices. The spot

115. See Fox, supra note 7, at 116.
116. See, e.g., 15 U.S.C. § 3312 (ceiling prices for new natural gas and certain natural gas produced from Outer Continental Shelf); id. § 3313 (ceiling price for new, onshore production wells); id. § 3314 (ceiling price for sales of natural gas dedicated to interstate commerce).
117. Id. § 3331(a).
118. Id. § 3331(c).
119. Id. §§ 3371, 3431. While the NGPA deregulated the price of certain categories of natural gas in interstate commerce, sections 4 and 5 of the NGA still regulate prices to ensure that they are “just and reasonable.” 15 U.S.C. § 717(c), (d) (1988).
120. Pierce, supra note 20, at 12. Professor Pierce argues that the shortage which prompted passage of the NGPA did not exist right before the NGPA was passed. Id. The General Accounting Office found that a natural gas surplus developed on the market as early as 1981. NATURAL GAS PRICE INCENTIVES: A PRELIMINARY ANALYSIS, REPORT BY THE UNITED STATES GENERAL ACCOUNTING OFFICE, GAO/RCED-83-76, at 27-28 (1982).
122. Pierce, supra note 19, at 354.
123. Order No. 436, supra note 6, at 42,412.
124. See Order No. 436, supra note 6, at 42,419-20.
market was significant because volumes of gas became available for short-
term sales at prices generally less expensive than gas sold subject to long-
term purchase contracts.\textsuperscript{125} As the gas spot market developed and natural
gas prices decreased, however, consumers were largely unable to take advan-
tage of the additional lower priced spot market supplies.\textsuperscript{126} Traditionally, the natural gas market operated this way: pipelines purchased gas from pro-
ducers, and then transported and resold the gas to LDCs for consumers
under long-term gas supply contracts. Because pipelines also had long-term
purchase contracts on the production end of their pipelines obligating them
to buy volumes at above-market levels, pipelines were reluctant to relieve
LDCs of any purchase obligations that would permit them to purchase the
cheaper gas.\textsuperscript{127} Further, for natural gas produced under their long-term
purchase contracts, pipelines were required to pay up to seventy to ninety
percent of the price of gas, whether or not the pipeline took the gas.\textsuperscript{128}
These take-or-pay clauses made pipelines more reluctant to release custom-
ers from purchase obligations.

Consumers had no opportunity to transport gas from the producing area
to the consuming area; they sat on one end of the interstate pipeline and
remained unable to take advantage of lower gas prices.\textsuperscript{129} They were also
paying above market prices for pipeline gas.\textsuperscript{130}

Recognizing the new competitive forces on the production end of the mar-
tket caused by the NGPA, the Commission promulgated a series of rulemak-
ings\textsuperscript{131} in an attempt to bring the evolving competitive forces at the wellhead

\begin{itemize}
\item \textsuperscript{125} Order No. 436, supra note 6, at 42,419.
\item \textsuperscript{126} Comment, supra note 121, at 848.
\item \textsuperscript{127} Stalon & Lock, supra note 121, at 488-89.
\item \textsuperscript{128} The impact of the “take-or-pay” liability on the natural gas market has been enor-
mous. However, the Commission only recently attempted to address the multi-billion dollar
take-or-pay obligations which have accrued over the last few years. Order No. 500, Interim
FERC, 912 F.2d 1496 (D.C. Cir. 1990).
\item \textsuperscript{129} Order No. 436, supra note 6, at 42,421. The pipelines were reluctant to provide their
transportation services to customers without fuel-switching capability, such as residential and
commercial customers. \textit{Id}.
\item \textsuperscript{130} See supra note 6. In addition to issuing rulemaking orders, the Commission also experi-
mented with innovative sale and transportation programs to bring some flexibility to the
interstate market. One of the innovations was the Special Marketing Program (SMP). Colum-
arrange with its producer-seller to release the pipeline from take-or-pay obligations in ex-
change for the pipeline's transportation of surplus supplies to industrial customers that otherwise
would not have purchased natural gas. Pipelines benefited from the SMPs because the SMPs
downstream to the consuming end of the natural gas market. Of these
rulemakings, Order No. 436 was the most significant action taken by the
Commission in the post-NGPA era.\textsuperscript{132}

The Commission promulgated Order No. 436 to increase competition in
the natural gas marketplace.\textsuperscript{133} The Commission attempted to convert an
industry previously controlled by governmental regulation into an industry
where competition would control the market.\textsuperscript{134} Because of an increase in
the number of interstate pipelines serving customers, a significant change
from the market conditions which prompted Congress to pass the NGA, the
Commission asserted that concerns regarding monopoly and discriminatory
practices of pipelines were alleviated in the natural gas market of the
1980's.\textsuperscript{135} According to the Commission, the new market required less di-
rect governmental intervention and the Commission could rely on market
competition rather than regulation to protect consumers.

Order No. 436's main objective was to permit consumers to take advan-
tage of the competitive market in the production fields by requiring inter-
state pipelines to provide "open access" contract carriage of natural gas.\textsuperscript{136}
The interstate pipeline would "unbundle" their transportation and sales
services and offer them separately. Thereafter, rather than being limited to
purchasing high-priced contract gas from the pipeline, LDCs and industrial
customers could purchase inexpensive natural gas on the spot market di-
rectly from producers, and request pipelines to transport the gas for a trans-
portation fee.\textsuperscript{137} To avoid the locked-in contract problems that had
precluded pipelines from allowing customers to purchase gas elsewhere, the

\textsuperscript{132} Associated Gas Distribus. v. FERC, 824 F.2d 981, 993 (D.C. Cir. 1987), cert. denied,
485 U.S. 1006 (1988). "The Order envisages a complete restructuring of the natural gas indus-
try. It may well come to rank with the three great regulatory milestones of the industry . . . ."
\textit{Id.} For a thorough analysis of Order No. 436, see Fox, supra note 7.
\textsuperscript{133} See Fox, supra note 7, at 118.
\textsuperscript{134} See Stalon & Lock, supra note 121, at 489; Order No. 436, supra note 6, at 42,413.
\textsuperscript{135} Order No. 436, supra note 6, at 42,412 (indicating that pipeline to pipeline competi-
tion is a common phenomenon).
\textsuperscript{136} \textit{Id.} at 42,424; see also Broadman & Kalt, supra note 11, at 184.
\textsuperscript{137} Order No. 436, supra note 6, at 42,425.
Order permitted customers to modify their contracts with the pipelines to trade sales service for transportation service.138

Another major aspect of Order No. 436 was the creation of a new pipeline certificate mechanism allowing pipelines to provide the anticipated new transportation. The optional expedited certificate procedure (OEC)139 allows a pipeline to construct facilities without having to satisfy certain requirements otherwise needed to meet the NGA's section 7 public convenience and necessity standard.140 Thus, under the OEC procedure, an applicant can request authority to bypass an LDC and face less rigorous public convenience and necessity review.141 One of the reasons the Commission proposed a limited review of OEC applications was that the pipeline constructing the facilities would assume the risk of the project.142

In addressing the decreased regulatory oversight contained in the OEC mechanism, the Commission first indicated a change in its historic LDC bypass preference. With its goal of economic efficiency, Order No. 436 reflects the Commission's belief that competition, rather than government intervention, will regulate the gas industry, and that players in the market that do not compete will not be protected.143 Thus, Order No. 436 embodies a substantial shift in the Commission's regulatory perspective. Instead of protecting consumers against transactions that may directly increase rates, the Commission now protects competition, and will not interfere in the changes brought on by the new competitive marketplace.

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138. 18 C.F.R. § 284.10 (1990). Under the Order, pipeline sales customers could convert a percentage of their sales service to transportation service on the pipeline. Id. § 284.10(c)(3)(ii)(A)-(E).
139. Id. § 157.104.
140. For example, the applicant may not be required to go through a formal administrative hearing as mandated under section 7 of the NGA before the certificate is issued. Id. § 157.104(b).
141. Under traditional section 7 certificate procedures, the applicant requesting the certificate has the burden to prove that the certificate is in the public convenience and necessity. 15 U.S.C. § 717f(c) (1988). Under the OEC procedure, however, the Commission presumes that the certificate is in the public convenience and necessity and places the burden on those opposing the certificate to prove otherwise. 18 C.F.R. § 157.104(c). For a small LDC facing bypass, the shift in burdens is significant, and may make defending against a bypass difficult.
143. Order No. 436 announced:

The Commission will not insulate the LDC markets from the competitive incentives that are the foundation of [Order No. 436]. In order to promote economic efficiency — a necessary factor in providing gas to consumers at the lowest reasonable rates — the rule must provide sufficient competitive incentives to all elements of the market. This means making all market participants, including LDCs, accountable for the success or failure of their market participation.

Order No. 436, supra note 6, at 42,469.
After its promulgation, nearly every segment of the natural gas industry sought appellate review of Order No. 436. In *Associated Gas Distributors v. FERC*, distributors and state utility commissions challenged the Commission’s shifting stance on LDC bypass announced in Order No. 436 on the grounds that permitting LDC bypass would harm LDC customers in violation of congressional intent and prior Commission policy. Specifically, the LDCs and state commissions argued that customers having the capability to bypass the LDC will do so and leave the remaining customers with an increase in the costs incurred by the LDC. In *Associated Gas Distributors*, the United States Court of Appeals for the District of Columbia Circuit largely approved of Order No. 436, but vacated and remanded it to the Commission because the court found fault with certain interdependent elements of the Order.

In its opinion, the court upheld the Commission’s new bypass policy. The court indicated that although Order No. 436 made Commission approval of LDC bypass more likely, the record contained little evidence that “industrial consumers desired to bypass their LDCs.” The court maintained that all of the LDCs’ customers desired competitive rates; thus, the only thing that LDCs had to do to maintain these customers was to compete in the new deregulated industry. Contrary to petitioners’ arguments, the court determined that customers would not automatically be burdened with increased costs. Instead, the court reasoned that state utility commissions, under their authority to regulate the rates LDCs charge their customers, could reduce the risk to LDC consumers by setting rates which would prevent the LDCs from shifting the costs to remaining customers. The court speculated that state commissions could adopt rate structures to ensure cost-based, competitive rates to protect residential consumers by requiring utility

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144. Producers, pipelines, LDCs, and endusers collectively filed 85 briefs and the court held two days of oral argument to hear the case. *Associated Gas Distrib.,* 824 F.2d at 994.
145. *Id.* at 981.
146. *Id.* at 1035.
147. *Id.* These parties asserted that the pipelines would seek out “lucrative customers” or “skim the cream” of the LDCs’ customers and leave the LDCs with the less lucrative customers. *Id.*
148. *Id.* at 1044. Shortly after the court issued its mandate, however, the Commission issued an interim rule and policy statement which reinstated those elements of Order No. 436 that the court approved. Order No. 500 Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (1987), aff’d, American Gas Ass’n v. FERC, 912 F.2d 1496 (D.C. Cir. 1990).
149. *Associated Gas Distrib.,* 824 F.2d at 1035.
150. *Id.*
151. *Id.*
152. *Id.*
company shareholders to absorb the cost of a bypass. The court also predicted that the state utility commissions could exert jurisdiction over the construction of any proposed bypass facility and require the new facility to obtain a certificate from the state commission before commencing operation.

The petitioners argued that the Commission's reliance on state utility commissions to fully protect residential consumers effectively delegated its NGA obligations to the states. The court disagreed, and read the NGA as simply a measure to fill a "regulatory gap" created by a series of pre-NGA Supreme Court opinions. The court maintained that the Commission's apparent "delegation" of consumer protection to the state commissions was not inconsistent with the intent of the NGA's consumer protection role. Specifically, the court interpreted the NGA as only requiring the Commission "to facilitate the flow of competitively-priced gas into the hands of gas consumers everywhere."

Judge Mikva, in his dissent on the issue of LDC bypass, recognized that states often require LDCs to subsidize consumer prices by charging higher rates to industrial endusers. He contended that state utility commissions requiring LDCs to subsidize residential rates by setting higher rates for industrial customers increased the chances that the LDCs would be subject to bypass. Judge Mikva asserted, however, that such subsidization to ensure affordable rates for residential customers was common in utility ratemaking, and that it was a "quintessential" local concern to be regulated by the state.

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153. Id. at 1036.
154. Id. at 1035-36. The court relied on Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951), for the basis that state utility commissions could retain jurisdiction over the bypassing transportation. Id. at 1035. The court acknowledged, however, that the bounds of the Supreme Court's holding in Panhandle were "unplumbed," and it avoided determining the extent of the issue because the question was not before it. Id. The protections anticipated by the court from Panhandle, however, are easily circumvented and provide little protection to consumers. See infra text accompanying notes 192-195.
155. See supra notes 4-5 and accompanying text.
156. Associated Gas Distribs., 824 F.2d at 1038. This interpretation could hardly be correct. In passing the NGA, Congress mandated just and reasonable rates, and not competitive rates. 15 U.S.C. § 717c(a) (1988). By relying on competitive market forces rather than traditional utility ratemaking methods to establish "just and reasonable" rates, the Commission failed to fulfill its statutory mandate. See, e.g., Farmers Union Cent. Exch., Inc. v. FERC, 734 F.2d 1486, 1509-10 (D.C. Cir.) (indicating that "just and reasonable" requires more from an agency than reliance on market competition), cert. denied, 469 U.S. 1034 (1984).
157. Associated Gas Distribs., 824 F.2d at 1044 (Mikva, J., concurring in the judgment and dissenting in part). Judge Mikva was particularly concerned with the majority's overbroad "loose language and stray observations" of the natural gas industry. Id.
158. Id. at 1045.
159. Id.
utility commission. Finally, Judge Mikva argued that the Commission's change in policy and the majority's reliance on state commissions to remedy adverse effects from LDC bypass improperly usurped the states' ability to make such policy choices.

The Commission's shift away from the LDC preference, as demonstrated in Order No. 436, appears to rest on the Commission's misperception that it had, in its prior anti-bypass preference, protected the LDCs from competition for the LDCs' benefit. Close inspection of the Commission's LDC preference, however, reveals that the Commission developed the preference not necessarily to protect the LDC, but to protect those customers without the capability to bypass the LDC. Although the Commission accurately recognized that changes in the marketplace required decreased regulatory oversight for some, it did not recognize that for other segments of the market a lack of competition still exists. Residential consumers cannot use the new competitive market to their advantage. Therefore, the Commission's announcement in Order No. 436, indicating that it would not protect the LDCs from competition and that "all market participants [would be] accountable for the success or failure of their market participation," offers no protection to residential customers, and effectively leaves the residential consumer out in the cold. Ironically, the Commission's bypass preference protected those captive consumers. Now, with the demise of the LDC preference, consumers have lost the necessary protection they once had.

The court of appeals' analysis of Order No. 436 failed to perceive this distinction. Specifically, the court's reading of the NGA as a passive oversight statute is inconsistent, not only with the NGA's legislative history, but also with prior Supreme Court interpretations of the NGA. Furthermore, the court's understanding of the LDC market appears to be conceptually flawed. The court asserted that bypass would occur only if the LDC was operating in an inefficient or discriminatory manner. The court overlooked the basic problem that, even if the LDC operated in an efficient or

161. Id. Judge Mikva stated: "I believe the Commission, and now this court, too quickly dismissed these important concerns about intrusion into the states' sphere of authority and too casually disregarded the needs of the everyday consumer, whose energy bill is likely to increase dramatically as a result of this ill-considered provision." Id. at 1045-46.
162. This misperception is evidenced by the terms the Commission uses in Order No. 436, indicating that it will no longer protect LDCs from market forces. Order No. 436, supra note 6, at 42,469.
163. Id.
164. See supra notes 62-78 and accompanying text.
165. Id.
166. Associated Gas Distrib., 824 F.2d at 1035.
nondiscriminatory manner, a retailer could not effectively compete with its wholesale supplier for the same customers. Therefore, the only way that an LDC could "beat" the pipeline would be to sell the gas at a loss or to recover the costs from existing customers or shareholders.\textsuperscript{167} Also, the court overlooked the fact that the competitive market was a reality for only certain segments of the natural gas market.

V. RECENT LDC BYPASS CASES

Since issuing Order No. 436, the Commission has approved a number of requests to bypass LDCs,\textsuperscript{168} and recent cases reflect the Commission's current passive attitude toward protecting the residential consumer. The cases also indicate that leaving residential protection in the hands of state utility commissions is inadequate because state authorities may be preempted, or otherwise be precluded from adequately responding to the bypass and from protecting their residential natural gas consumers. Some courts have recognized the harm to consumers from bypass and have suggested that the Commission act to ensure consumer protection.

In \textit{Northern Natural Gas Co.},\textsuperscript{169} the Commission issued Northern Natural, an interstate pipeline, a certificate of public convenience and necessity to serve Terra International, Inc. Terra, a fertilizer manufacturer, previously purchased 100\% of its natural gas from Iowa Public Service (IPS), an LDC.\textsuperscript{170} IPS protested the proposed bypass and raised several arguments previously recognized by the Commission as grounds for denying a bypass request. Specifically, IPS argued that the bypass would unfairly impact its remaining retail customers.\textsuperscript{171} Moreover, IPS criticized the proposed bypass because it would require duplication of facilities. IPS also argued that after

\begin{itemize}
  \item 167. For example, if the interstate pipeline sells gas at $2.00 per Mcf, for the LDC to compete it would also have to sell the gas at $2.00 per Mcf. However, the LDC incurs costs in transporting the gas from the interstate pipeline to its customers and those costs are added to the $2.00. Therefore, if the LDC competes with the pipeline and sells the gas at $2.00, it would either sell the gas at a loss or allocate the lost costs to the remaining customers or its shareholders through a lower dividend.
  \item 169. 46 F.E.R.C. \textsuperscript{\$} 61,270 (1989).
  \item 170. \textit{Id.} at 61,792. IPS served Terra pursuant to a 20 year contract. The contract expired in June, 1987, and IPS served Terra on a month to month basis thereafter. \textit{Id.}
  \item 171. Terra leaving the IPS system meant that IPS would lose $650,000 in annual revenues. \textit{Id.} at 61,793. Based on this loss, IPS computed that the bypass would result in an increase in its sales rates to its remaining customers of 1.5 cents per Mcf. \textit{Id.}
\end{itemize}
the bypass Terra might not receive adequate service and, therefore, IPS was left with the burden of having to stand ready to serve Terra without receiving any compensation.\textsuperscript{172} Similarly, the Iowa State Utilities Board protested the bypass, arguing that the Commission's new role in addressing bypass intrudes into a local matter, and thus the proposal should be left for local officials to regulate.\textsuperscript{173}

Finding that the proposed bypass was required by the public convenience and necessity, the Commission rejected IPS' and the Board's protests.\textsuperscript{174} The Commission reasoned that, under its new LDC bypass policy, both IPS and Northern Natural could compete for Terra's business.\textsuperscript{175} To the extent that IPS' remaining customers would be adversely affected by a bypass, the Commission noted that the State Board could change IPS' rates so that IPS would internalize the loss or the LDC's shareholders would bear the burden.\textsuperscript{176} However, the Commission refused to address the concerns of residential customers. Its refusal was based on the principle that, "[i]n a competitive market environment, the parties are at risk for their own decisions, and the need to provide competitive services is a factor that leads to improved service at lower cost for consumers."\textsuperscript{177} Moreover, the Commission asserted that its only obligation under the NGA was to establish "conditions by which the gas arrives in the hands of consumers or LDCs on terms that conform to the [NGA]."\textsuperscript{178}

\textsuperscript{172} \textit{Id.} at 61,792.
\textsuperscript{173} \textit{Id.} at 61,794.
\textsuperscript{174} \textit{Id.}
\textsuperscript{175} \textit{Id.}
\textsuperscript{176} The Commission's conclusion that the LDC's shareholders can bear the loss of revenue by decreased dividends, rather than the LDC's customers bear the loss by increased rates, is only facially persuasive. Specifically, the conclusion does not reconcile with fundamental ratemaking principles and United States Supreme Court precedent on ratemaking methodologies. These principles require that a rate set by a commission cannot be so low as to not allow the utility an opportunity to earn a reasonable return on its capital investment. See, e.g., Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989). A rate set below a reasonable return level would constitute an illegal taking under the Constitution. \textit{Id.} at 616. Moreover, because the state utility commission desires the LDC within its jurisdiction to remain in operation to provide public service, it sets rates which allow an opportunity to collect an adequate return on investment so that the LDC can solicit adequate funds from investors. See J. TOMAIN, supra note 27, at 165. If investors realized that with each bypass of the LDC they would suffer a decreased chance of a return on their stock in the company, they would unlikely remain investors, or become investors, in LDCs.
\textsuperscript{177} \textit{Northern Natural Gas Co.}, 46 F.E.R.C. ¶ at 61,270 (quoting American Gas Dists., 37 F.E.R.C. ¶ 61,282, at 61,854-855 (1986)).
\textsuperscript{178} \textit{Id.} at 61,794 (quoting Associated Gas Dists. v. FERC, 824 F.2d 981, 1036 (D.C. Cir.), cert. denied, 485 U.S. 1006 (1987)).
On rehearing of the initial order, the Commission elaborated on its new view toward LDC bypass. The Commission acknowledged its prior "qualified preference" for LDCs over pipelines to serve industrial endusers. The Commission maintained, however, that any preference should only be applied on a case-by-case basis to appropriately protect the competing interests of the LDC and the industrial enduser.

Under its current policy "to encourage access between willing buyers and sellers of natural gas in an atmosphere of fair competition," the Commission requires the LDC to compete with the interstate pipeline or lose business. The Commission concluded that the benefits of competition outweigh its detriments and inure to all market participants, even those remaining on the LDC after bypass.

The state utility commission and the LDC argued that the Commission's suggestions to change the state-determined retail rates to protect consumers against bypass intruded on state policy prerogatives. For example, the Commission suggested that the state utility commission could require LDCs to provide "open access" to their industrial customers to enable customers to arrange their own supplies and simply use LDCs to transport the gas. The Commission also suggested that the state commission could establish maximum and minimum rates, reallocate fixed costs between industrial customers and residential consumers, and require stockholders of LDCs to bear some of the shifted costs. Because intrastate rate matters are within the jurisdiction of state commissions, the Commission has no authority to require state commissions to implement such changes. Therefore, the recommendations did little for post-bypass customers.

Even where state commissions have acted to protect their consumers from an LDC bypass, courts have rejected the attempts because the Commission's

179. 48 F.E.R.C. ¶ 61,232 (1989). Section 19 of the NGA, 15 U.S.C. § 717r (1988), allows any party "aggrieved" by a Commission order to ask the Commission to rehear an order. On rehearing, the Commission has the authority to modify or abrogate its prior order. Id. Regulated companies frequently use the Commission's rehearing procedure.


181. Id.

182. Id. at 61,828; see also Williams Natural Gas Co., 47 F.E.R.C. ¶ 61,080 at 61,080 at 61,225-226 (1989).


184. Id. The Commission did indicate, however, that it would limit LDC bypass if achieved through unfair competition. Id.

185. Id. at 61,826.

186. Id. at 61,829.

187. Id. But see supra note 176 (shifting costs to shareholders may violate ratemaking principles and deter private investment in public utilities).
decision to allow the bypass preempts subsequent state efforts to control the transaction. Although the United States Supreme Court has held that intrastate transportation and rate matters are within the control of the state commissions, parties desiring bypass can easily avoid state regulation by structuring their natural gas transaction as interstate commerce. In *Panhandle Eastern Pipe Line Co.*, the Commission permitted Panhandle Eastern to bypass LDC Michigan Consolidated Gas Company to serve National Steel directly. The Commission again relied on the virtues of competition as the basis for allowing the pipeline, and industrial customer, to bypass the LDC.

While the Commission allowed the bypass, the Michigan Public Service Commission (Michigan PSC) also attempted to exert jurisdiction over the proposed bypass. Pursuant to Michigan law, the Michigan PSC has authority over gas sales and over the facilities that are used to sell the gas in the state of Michigan. In *National Steel Corp. v. Long*, the United States District Court for the Western District of Michigan held that the Michigan PSC could not exert jurisdiction over the bypass because the transaction was interstate commerce and was exclusively under the federal Commission's jurisdiction. After recognizing that a state maintains jurisdiction over the retail sale of natural gas to consumers within its borders, the court held that, because National Steel purchased the gas in Oklahoma rather than in Michigan, the gas delivered in Michigan was only delivered as the tail end of interstate commerce. Accordingly, the court concluded that the Michigan PSC did not have jurisdiction over the transaction and that the Michigan PSC

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190. *Id.* at 61,751. The Commission held:

> "In a competitive market environment, the parties are at a risk for their own decisions, and the need to provide competitive services is the factor that leads to improved service at lower cost for consumers. . . . Under these circumstances, and in the absence of any suggestion of unfair competition, we believe that the public interest is best served by our sustaining the result of that competition."

*Id.* (quoting American Distrbs. Co. 37 F.E.R.C. ¶ 61,282 (1986)).
193. *Id.* at 738.
194. *Id.* at 732; see also 15 U.S.C. § 717(b) (1988).
PSC was precluded from implementing consumer protection plans. Still, after holding that the state utility commission was preempted from regulating the bypass, the court raised the interest of residential consumers. The court acknowledged that, because the federal Commission occupied the field and the state commission was limited in what it could do to address consumers' concerns, the federal Commission should act to protect the residential consumers' interests.

Likewise, in Kansas Power and Light Co. v. FERC, the United States Court of Appeals for the District of Columbia Circuit upheld a Commission order approving a bypass, but directed the Commission to address claims that its bypass policy thwarted state efforts to allocate to industrial customers those costs incurred while serving residential consumers. In Kansas Power and Light, the Commission permitted Williams Natural Gas Company to bypass Kansas Power and Light Company to serve an industrial customer pursuant to a section 7 blanket certificate. In upholding the Commission's LDC bypass policy, the court acknowledged that the Commission relied on competition as the best manner to serve the public interest. Further, the court noted that the Commission had moved "from a tilt against bypass to a tilt in its favor." Despite this change in Commission policy, however, the court recognized that the Commission's bypass policy must be consistent with its statutory grant under section 7 of the NGA and that the Commission must control market entry when necessary, that is, when it is not in the public convenience and necessity. Accordingly, the court stated that "if parties oppose bypass on the ground that it thwarts state efforts to subsidize residential customers with economic rents secured from businesses, the Commission will have to address such claims."

195. National Steel, 689 F. Supp. at 733. In Oklahoma Natural Gas Co. v. FERC, 906 F.2d 708 (D.C. Cir. 1990), the court questioned the Commission's broad reading of the NGA to determine that a bypass is in interstate commerce. In Oklahoma Natural Gas Co., Williams Natural Gas sought to bypass Oklahoma Natural Gas Co., an LDC, by transporting the gas from one point in Oklahoma to another point in Oklahoma. Because the NGA regulates transportation of natural gas in interstate commerce, the LDC argued that the transportation was outside of the Commission's jurisdiction. Id. at 710. The court agreed and remanded the decision back to the Commission for it to further explain its finding that the transportation was in interstate commerce. Id. at 713.


197. 891 F.2d 939 (D.C. Cir. 1989).


199. Kansas Power & Light, 891 F.2d at 941.

200. Id. at 942.

201. Id. at 943.

202. Id.
VI. LDC Bypass: Are Residential Consumers Being Left in the Cold?

A. Critique of the Commission’s Bypass Policy

The Commission’s deregulation orders aim to fulfill NGA requirements through market competition rather than governmental intervention.\(^{203}\) In easing its regulatory controls over the industry, and thereby allowing the “invisible hand” of competition to direct the market, the Commission has permitted and encouraged segments of the industry previously shielded from competition to compete directly.\(^{204}\) While previously adhering to the position that certain elements of the industry such as interstate pipelines and LDCs should not compete directly because such competition would result in increased costs and higher rates to consumers,\(^{205}\) the Commission, in the deregulation era, now promotes competition as the method for controlling service and rates.\(^{206}\) Central to the Commission’s argument is the principle that, in the current market, all market participants can compete and, therefore, should be held responsible for their actions in the competitive marketplace.\(^{207}\)

Unfortunately, the Commission has consistently failed to recognize, or even acknowledge, that competition in the “deregulated” market is not available for certain consumers in the gas industry. Residential consumers, those who are limited to purchasing their gas from the LDC to heat their homes and to cook their meals, cannot realistically take advantage of the competitive market.\(^{208}\) They cannot shop around for the most competitively priced natural gas. Instead, because of the significant investment involved in purchasing and distributing natural gas, they will remain obligated to purchase gas from their LDC.\(^{209}\) The typical residential consumer cannot afford to construct a direct hookup with the interstate pipeline. Further, the residential consumer neither demands the volume of natural gas required to make a hookup economically feasible nor possesses the business expertise to negotiate for natural gas supplies.\(^{210}\)

Therefore, the competition created by the Commission at the interstate level does not, and realistically cannot, operate on the residential consumer level. Ironically, the NGA requires the Commission to protect the con-

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\(^{203}\) See supra note 6.

\(^{204}\) Order No. 436, supra note 6, at 42,469.

\(^{205}\) See supra notes 78-105 and accompanying text.

\(^{206}\) Order No. 436, supra note 6, at 42,413.

\(^{207}\) Id. at 42,469.

\(^{208}\) See supra text accompanying notes 42-47.

\(^{209}\) Id.

\(^{210}\) Id.
sumer, particularly the residential consumer, from unreasonable rates and unfair market pressures and the old LDC bypass policy did just that.\textsuperscript{211} Under the new bypass policy, however, the Commission fails to protect residential consumers. Rather, the Commission appears to be protecting competition for competition's sake, even though it is the consumer, and not competition, that the NGA requires the Commission to protect. While the Commission's policy to increase competition may be a good one for those who can compete, many cannot. As long as its statutory mandate to protect consumers exists, the Commission must comply with that mandate.\textsuperscript{212}

\textbf{B. Recommendation: A More Active Role for State Commissions}

The Commission's bypass policy has left residential customers without adequate market protection. Residential customers in the 1990's are facing the same dilemma that customers faced before Congress passed the NGA. Before passage of the NGA, the lack of competition harmed residential consumers and state utility commissions were preempted from taking an active role in regulating the transactions.\textsuperscript{213} Today, while some elements of the market do enjoy increased competitive alternatives, residential consumers do not. Just as the unfair impacts on consumers in the 1930's required federal legislation, federal legislation may be necessary to provide consumers with protection in the 1990's. While the Commission suggests that state utility commissions already have the authority to prevent LDC bypass, or at least to mollify its adverse effects on residential consumers, case law has shown that the state utility commissions are limited in what they can do.\textsuperscript{214}

State utility commissions are currently ill-equipped to protect the residential consumers who are adversely affected by LDC bypass. Because Congress directed the Commission to protect consumers in accordance with the suggestions of \textit{National Steel} and \textit{Kansas Power and Light}, the Commission should consider and evaluate concerns raised by residential consumers rather than passively rely on competitive forces to do the job. Particularly, because LDC bypass transactions can be structured to avoid state utility commission jurisdiction, the federal Commission should act to protect consumer interests in those cases. Given the determination of the Commission in pressing its new LDC bypass policy,\textsuperscript{215} however, it is unlikely that the Commission will follow the urging of \textit{National Steel} and \textit{Kansas Power and Light}. If the Commission continues to refuse to reevaluate its LDC bypass

\begin{itemize}
  \item \textsuperscript{211} See supra notes 4-5.
  \item \textsuperscript{212} See Maislin Indus., U.S., Inc. v. Primary Steel, Inc., 110 S. Ct. 2759, 2770 (1990).
  \item \textsuperscript{213} See supra text accompanying notes 56-73.
  \item \textsuperscript{214} See supra notes 192-202 and accompanying text.
  \item \textsuperscript{215} See supra text accompanying notes 203-07.
\end{itemize}
policy, state utility commissions should be permitted to exert some control over LDC bypass. One method to ensure protection for residential consumers is for Congress to enact legislation that provides state utility commissions with the authority to address LDC bypass while maintaining its full panoply of state regulatory prerogatives.216

Because LDC bypass may have positive effects, the state utility commissions should not be allowed to automatically bar LDC bypass. Rather, state utility commissions should be permitted to review bypass proposals and to determine whether the bypass is in the best interest for all of its consumers, residential and industrial alike.217 While state utility commissions have allowed LDC rates to favor the residential consumer over the industrial customer, allowing states to regulate bypass will not necessarily jeopardize industrial competitive rates for industrial customers. The state utility commissions are closer to the local distribution market. Thus, they are better equipped to achieve a balanced and efficient trade off between the industrial and residential consumer.218 Further, industrial customers could exert political pressure on the state commissions to urge balanced and efficient LDC rates. For example, evidence that an industrial customer may shut down or lay off employees because of expensive fuel costs could prompt the state commission to reduce the LDC's rates or allow the bypass. The important aspect of this alternative, and the aspect that is missing from the Commission's analysis of bypass cases, is that if the state commissions were permitted to act, the interests of the residential consumer would be considered.

216. Pending before the United States House of Representatives at the end of the 101st Congress was H.R. 540, 101st Cong., 1st Sess. (1989), entitled the “Natural Gas Transition Act of 1989.” The bill prevented the Commission from authorizing a bypass if a local or state utility commission certified that “the service would prejudice the present or future interests of the customers of the affected local distribution company,” or if an affected LDC protests the bypass and the parties attempting the bypass cannot show that the LDC is unwilling to provide the service. In the 102nd Congress, natural gas legislation may remain a high legislative priority, and the bill may be reintroduced.

217. Some states have adopted such measures. See D. MUCHOW & W. MOGEL, ENERGY LAW AND TRANSACTIONS § 57.04(5) (1990). For example, some states have allowed LDCs to condition the ability of industrial customers to return to the LDC system after they bypassed the LDC. These measures do not prevent LDC bypass and only provide relief when the customer returns, if at all. Some states have enacted statutes to reject bypass proposals. Id. (citing IND. CODE ANN. § 8-1-2-87.5 (Burns 1986 Supp.)). Because the NGA may preempt state statutes regulating LDC bypass, such statutes may also offer little protection against LDC bypass. Finally, some states have followed the Commission’s suggestions and revised their LDC rates to more evenly allocate costs between residential and industrial customers. Id.

218. See Note, Preemption and Regulatory Efficiency in Federal Energy Statutes, 103 HARV. L. REV. 1306, 1315-16 (1990) (arguing that under a preemption analysis, courts should permit the most efficient regulator to regulate the transaction).
VII. CONCLUSION

Congress decided to ensure consumer protection in the interstate natural gas market by enacting the NGA. For years, the Commission considered residential consumer interests when reviewing LDC bypass cases. In the deregulated market, the Commission has changed its policy from protecting the consumer to protecting competition. As a result of the Commission's change in policy, segments of the industry that cannot compete, particularly residential customers, suffer the adverse affects of competition. Despite the congressional mandate of the NGA, the Commission is no longer actively protecting this group.

Because federal protection of these captive consumers no longer exists, the regulatory void should be filled by state regulatory agencies. The options offered by the Commission to the captive customers are neither viable nor responsive to the problem. Therefore, state utility commissions should be allowed to step into the "bypass arena" to ensure that captive customers enjoy the regulatory protection they continue to need.

Martin V. Kirkwood